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Fostering Markets for SME Finance

MATCHING BUSINESS AND INVESTOR NEEDS

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Fostering Markets for SME Finance: Matching Business and Investor Needs

Final report

This document contains the final report on fostering markets for SME finance, as part of the Working Party on SMEs and Entrepreneurship's (WPSMEE) Programme of Work for 2015-2016.

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ABSTRACT

The 2008-09 global financial crisis had a profound impact on the availability of bank credit for SMEs. Although a decline in the demand for bank credit played an important role, banks have also become more reluctant to lend, including as a consequence of new capital requirements. Moreover, a longstanding financing gap exists for SMEs with a high risk/return profile, such as start-ups, fast-growing and highly innovative SMEs. While bank financing will continue to be crucial for SMEs, broadening the financing options would enable SMEs to better seize growth opportunities and reduce their vulnerability to changes in credit market conditions and economic downturns.
The present study analyses key impediments to SMEs' uptake of alternative financial instruments, both on the demand- and supply-side. The study discusses the role of policy in fostering SME finance markets and reviews recent trends in policy measures to support the development of alternative financial instruments for SMEs.

JEL codes: G23, G28, G32, L26
Keywords: SME Finance, Financial Crisis, Non-bank Finance, Equity, Financial Skills, Public Policy

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Executive Summary

This paper builds on and develops further earlier OECD work on finance instruments complementary to straight debt, most notably "New approaches to SME and entrepreneurship financing: Broadening the range of instruments", which identified various challenges on both, the demand as well as on the supply side of finance markets, that restrict SMEs' uptake of alternative financial instruments. That report formed the basis for the development of the G20/OECD High-Level Principles on SME Financing, welcomed by Leaders in November 2015.

The profound impact of the financial crisis on the availability of bank credit continues to drag on SMEs' access to finance in particular, with bank lending volumes remaining below pre-crisis levels in many countries. While bank financing will continue to be crucial for the SME sector across all economies, complementing straight debt with other financing options would enable SMEs to better seize growth opportunities and make them less vulnerable to changes in credit market conditions and economic downturns.

A number of challenges persist, that limit SMEs' uptake of non-bank finance instruments – most of which are currently at the reach of only a small share of SMEs. On the demand side, many entrepreneurs and business owners lack financial knowledge, strategic vision, resources and sometimes even the willingness or awareness to successfully attract sources of finance other than straight debt. The lack of appetite for alternative financial instruments can also in parts be attributed to their tax treatment vis-à-vis straight debt. On the supply side, potential investors are sometimes hesitant to enter due to the overall opacity of the SME finance market, a lack of exit options, as well as persisting regulatory impediments. As a consequence of these obstacles, financial instruments for SMEs often operate in thin, illiquid markets, with a low number of market participants, which, in turn drives down demand from SMEs and discourages potential suppliers of finance. This paper takes a closer look at such challenges and argues that it is important to take a holistic view with respect to measures that may stimulate SMEs' uptake of non-bank finance instruments.

Governments have a variety of policy measures at their disposal to respond to these challenges. Indeed, in recent years many countries have introduced initiatives to improve the financial literacy of both business owners seeking finance and potential suppliers, so as to encourage investments in equity finance, in particular recognition of its importance for high-growth SMEs which have been identified as important drivers of economic competitiveness and development. Available evidence suggests that these types of policies can pay off. However, in order to successfully develop alternative finance instruments for SMEs as a complement to bank lending, demand-side and supply side barriers need to be addressed in tandem. Even if supply-side barriers are lifted, alternative sources of finance will remain underdeveloped as long as entrepreneurs continue to turn to bank lending as their default option when seeking finance. Conversely, tackling demand-side barriers will lead to limited access if supply-side issues remain a bottleneck. At the same time, a holistic view on SME access to finance also implies looking beyond demand and supply, and acknowledging that the interplay of both structural and cyclical variables is complex and often difficult to disentangle.

1. Introduction

The OECD Working Party on SMEs and Entrepreneurs (WPSMEE) initiated work to investigate the potential of finance instruments complementary to straight debt in 2011-12, resulting in a mapping of all finance options available to entrepreneurs and SMEs. "New approaches to SME and entrepreneurship financing: Broadening the range of instruments" explores the main features of a broad range of external financing techniques complementary to straight debt, as well as the enabling factors that contribute to the development of these instruments. The study contributed to the OECD-wide project on New Approaches to Economic Challenges (NAEC) and was welcomed by G20 Finance Ministers and Central Bank Governors in February 2015. It also formed the basis for the development of the G20/OECD High-Level Principles on SME Financing which were welcomed by Leaders in November 2015.

The research identified a range of impediments, both on the demand as well as on the supply side of finance markets that restrict SMEs' uptake of alternative financial instruments. To follow up on this work, the WPSMEE agreed to deepen its work on these key barriers as part of the PWB in 2015-16. On the demand side, the WPSMEE report highlighted the importance of a sufficient level of financial knowledge, as well as the development of a strategic vision of SME financing needs, as entrepreneurs and business owners often lack skills, resources or even the willingness to successfully attract sources of finance other than straight debt. On the supply side, potential investors in SME financial markets were sometimes found to be hesitant to enter because of a lack of investor-ready projects, the lack of exit options, the absence of a credit risk infrastructure to allow for an assessment of credit risks at reasonable costs, regulatory impediments, as well as an insufficient scale and liquidity on secondary markets to attract professional investors. As a result of these challenges, finance instruments alternative to straight bank debt have overall remained underdeveloped, especially in continental Europe, where venture capital investments, for instance, account on average for less than 0.05% of GDP (OECD, 2016).

The present study focuses on these key obstacles by examining both demand- and supply-side barriers. Furthermore, the study reviews recent trends in policy measures to support the development of alternative finance instruments for SMEs, including SME investor-readiness programmes and ways to incentivise institutional investors, retail investors and other potential market participants to enter SME equity markets, with the objective to identify good practices and policy recommendations.

2. Rationale: The case for developing non-bank finance instruments

The financial crisis had a profound impact on the availability of bank credit. The 2016 OECD Scoreboard on SME and entrepreneurship finance documents that bank lending to SMEs often declined dramatically in the years following the financial crisis and signals that there continues to be a financing shortfall in many countries. Although this slump was in part caused by a decline in the demand for bank credit, which invariably suffered significantly under the economic recession, banks have also become more reluctant to lend, and bank credit has become harder to come by for entrepreneurs and SMEs.

Moreover, the new capital requirements imposed on the banking sector push up costs and make it harder to obtain bank loans. Although this holds true for households, large enterprises and SMEs alike, the effects are especially pronounced for SMEs for several reasons. First, SMEs are much more dependent on bank lending than large firms, so a decline in the availability of bank loans is much more likely to impact their investment and growth prospects. This development has been particularly damaging to European SMEs that rely more on bank finance than their US counterparts, where non-bank credit channels have considerably mitigated the impact of the drought of straight bank debt (Véron, 2013). Second, credit to entrepreneurs and SMEs is likely to be disproportionately impacted by the financial

reforms. Among SMEs, start-ups, micro-enterprises and firms with innovative, but unproven business models already faced significant barriers to accessing finance before the crisis, and thus continue to be the most likely to be cut off from external financing given their risk profile. Third, SMEs' profitability suffered under the worsening economic climate. Their reduced profitability not only compounded their difficulties in obtaining bank lending, but also made it more difficult to replace external sources of finance with internal ones.

Moreover, traditional bank lending may not always be the most appropriate form of finance for many SMEs and entrepreneurs. In particular, debt financing is often ill-suited to the needs of start-ups, highly innovative firms and fast-growing SMEs. Although these firms form only a small minority of all SMEs, they account for a significant share of jobs created and are key players in achieving inclusive economic growth, and in contributing to innovation. Given the higher risk-return profile of these enterprises, their growth depends more on well-functioning growth capital markets, and less on the conditions in the credit market. Similar equity gaps also exist for firms undergoing an important transition, such as a change in ownership, a restructuring of activities, entry in foreign markets, and so on. Other finance instruments, often equity-based, may therefore be more suitable for these firms.

The most recent Scoreboard data illustrate that, although financial instruments other than bank lending are gaining traction, they have not been able to compensate for the retrenchment of bank lending. Likewise, the cyclicality of bank finance has proven particularly problematic in countries with less developed public financing markets. Gambacorta et al. (2014) find that, when an economic downturn is associated with a financial crisis, the real costs are three times larger in countries with bank-oriented systems than in those with a market-oriented financial structure. This is confirmed by a cross-country regression analysis by Pagano and Langfield (2014) that covers the 1989-2011 period, showing that in bank-oriented economies, the GDP growth rate is more strongly affected by severe drops in housing and stock prices than is the case in security-market-based economies. These studies thus provide evidence for the claim that SMEs which are less reliant on bank finance are less likely to be vulnerable to business cycles.

The SME financing gap, whose existence is particularly pronounced with respect to high-risk, high-return equity-type instruments, results in a mismatch between supply and demand. At the same time, there is clear potential to further mobilise financial markets as a source of finance for SMEs. The following sections of this chapter set out the case to promote alternative instruments of finance and make them more readily available to SMEs.

2.1. The existence of an SME financing gap

Capital markets have recently been gaining ground as a source of finance for private firms. However, this promising picture characterises mostly large companies that have relatively easy access to market finance as an alternative or complement to bank finance. In fact, large firms in Europe have, in the aggregate, become net providers of funds to the financial system. In contrast, there is mounting evidence that small and medium-sized enterprises face a pronounced financing gap (Giovannini et al., 2015).

The existence of an "SME financing gap" was already widely acknowledged prior to the financial crisis, with recent studies attempting to quantify its size (see Box 1). The purpose of these types of assessments is to identify and try to quantify the market failures or suboptimal investment situations, and investment needs, in order to inform public policy interventions (EIF, 2014). However, as the European Investment Fund (EIF) also notes, *"against the background of an environment of imperfect information and uncertainty, there is no perfect solution to assess (ex-ante) SME finance market gaps and the correct quantification of these gaps is impossible*". The study presented in Box 1 is thus simply an example of a

study trying to identify and analyse these issues and should be interpreted in context. Other studies have undertaken similar exercises, for example, Roxburgh et al. (2011) or the Government of Canada (2002).

Box 1. Estimating the financing gap of SMEs

In July 2015 the Duisenberg School of Finance published a report entitled *The European Capital Markets Study: Estimating the Financing Gap of SMEs* with the aim of quantifying the differences between supply and demand of finance provided to SMEs so as to determine the size of the existing financing in the debt and equity markets on a pan-European level.

The study uses publicly available data on SME outstanding loans and issued equity in order to estimate the supply of SME financing. In order to assess the demand for loans and equity among SMEs, the Survey on the Access to Finance of Enterprises of the ECB (ECB SAFE Survey) and publicly available data are used. In addition, data from statistical offices, as well as data collected through surveys were consulted to help gauge the financing demand. The survey focuses on a selected number of EU member state countries, in which small and medium enterprises were randomly selected and weighted based on economic importance. In order to provide a contextual meaning to the estimated numbers, the authors benchmark them against the SME loan and equity gap in the US. The main results are presented in the Table below. Due to the fact that three different methods are used to assess demand, several gap estimations were calculated. As a result, the table provides a range rather than an exact number, with sometimes considerable variations in size for certain countries.

	France	Germany	Netherlands	Poland	Romania	United States
Loan Gap	3.37 to 5.16	2.7 to 6.04	6.01 to 16.34	5.01 to 14.73	1.35 to 4.02	1.12 to 2.25
Equity Gap	2.23 to 3.06	2.07 to 3.18	0.70 to 3.95	0.44 to 3.49	4.83 to 13.05	0.96 to 1.52
Total Financing Gap	5.60 to 8.22	4.77 to 9.22	6.71 to 20.30	5.45 to 18.22	6.18 to 17.07	2.30 to 3.78

The study results put the estimated equity gap at 3% of GDP on average, thus suggesting that there is a significant difference between the estimated demand and supply of equity. What is more, the SME equity gap in researched countries is significantly larger than that in the US, indicating that conditions for US SMEs to access capital markets are better than for EU SMEs. Within that context, the importance of equity is highlighted in particular, as well-capitalised SMEs are usually able to mobilise further debt more easily, according to the study. The authors therefore conclude that filling the existing equity gap is probably more efficient than filling the loan gap.

Source: Lopez de Silanes, F, J McCahery, D Schoenmaker, and D Stanisic (2015).

2.2. A pronounced mismatch between supply and demand in the case of equity-type instruments

Although many of the obstacles to the development and uptake of alternative finance instruments by SMEs are common for many financing instruments available to SMEs across the risk-return spectrum, they are most acute for high-risk, high-return equity-type instruments at the right of the table depicted below.

Table 1. Alternative financing instruments

Low Risk/ Return	Low Risk/ Return	Medium Risk/ Return	High Risk/ Return
Asset-Based Finance	**Alternative Debt**	**"Hybrid" Instruments**	**Equity Instruments**
• Asset-based lending • Factoring • Purchase Order Finance • Warehouse Receipts • Leasing	• Corporate Bonds • Securitised Debt • Covered Bonds • Private Placements • Crowdfunding (debt)	• Subordinated Loans/Bonds • Silent Participations • Participating Loans • Profit Participation Rights • Convertible Bonds • Bonds with Warrants • Mezzanine Finance	• Private Equity • Venture Capital • Business Angels • Specialised Platforms for Public Listing of SMEs • Crowdfunding (equity)

Source: OECD (2015a).

Finance instruments that pose fewer risks to investors can flourish more readily and even in the absence of comprehensive, transparent, and standardised credit data, especially when backed by collateral or guarantees by the enterprise. Accessing asset-based finance instruments in particular depends on the liquidation value of the underlying asset, rather than on the creditworthiness of the business. Survey data also show that these instruments are more widely known and used by entrepreneurs compared with more risky finance instruments.

An additional reason to focus primarily on high-risk, high-return instruments is that these instruments cater to innovative and high-potential SMEs and start-ups, where traditional finance gaps are most acute. This segment is often not well served by the banking sector, because of their riskiness and opacity, and thus relies more on the development of alternative techniques. A recently published report by the British Business Bank (2016) highlights that both scale-up and established SMEs (referred to as stay-ahead SMEs in the report, i.e. firms that have been trading for five years or more) are more likely to see their new loan application approved (with success rates around 60%), while start-ups are more likely to be unsuccessful. When considering new overdrafts applications, a similar trend is evident, where scale-up and established SMEs have proven to be successful more often.

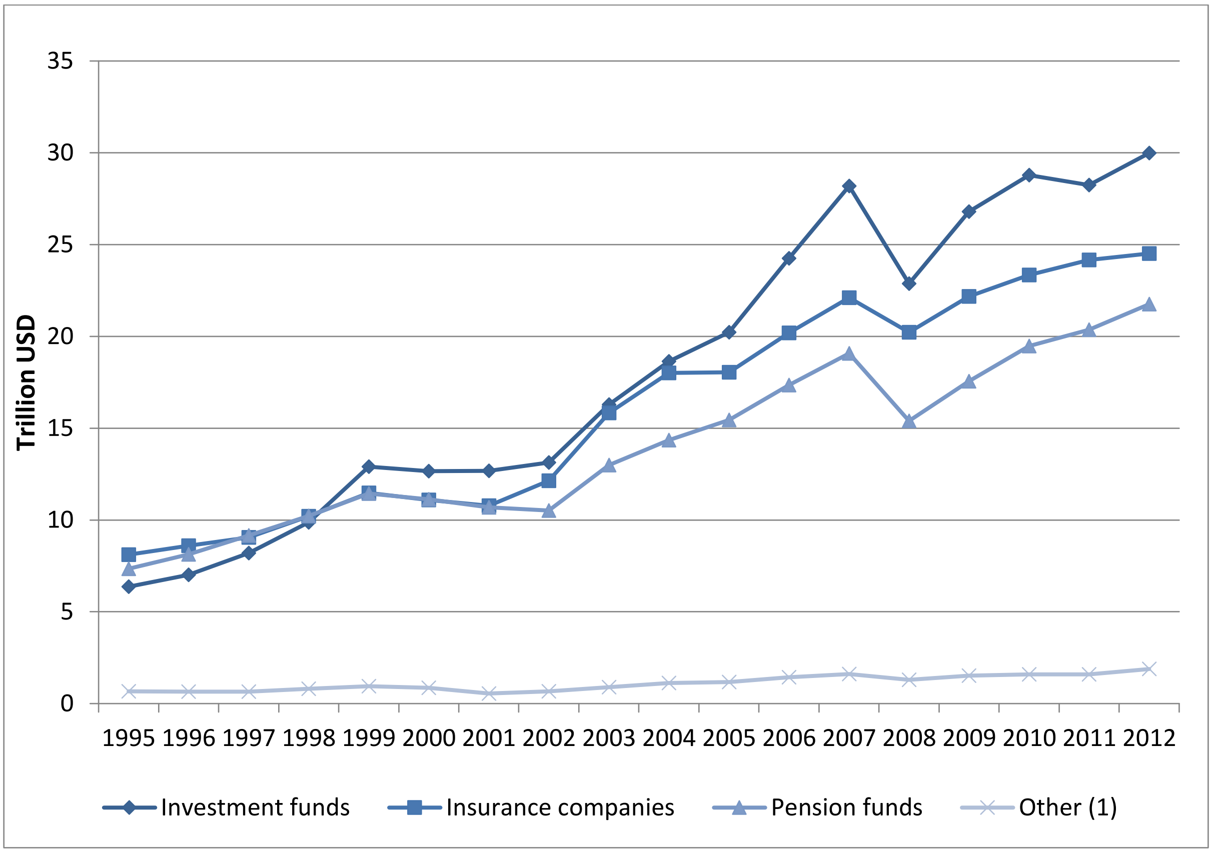
The OECD Scoreboard on SME and entrepreneurship finance highlights the increased interest of policy makers in developing equity finance. In recent years, many new initiatives with the explicit aim to encourage equity investments in innovative and high-potential SMEs have seen the light. The momentum to develop these markets is thus building, and there is a growing need to share policy experiences and identify good practices that have the potential to address the above-mentioned challenges.

2.3. Potential to mobilise financial markets as a source of finance for SMEs

Capital markets and the institutional investor base are generally only considered accessible to large enterprises, even though SME issuances can often deliver higher returns. SME issuances normally do not meet the prudential requirements of institutional investors and are often insufficiently liquid in the absence of a market making system. At the same time, the lack of easily available transparent loan-level and performance information on SMEs renders the necessary selection and monitoring process too costly or not possible. Post crisis, however, institutional investors increasingly started looking to diversify their investment portfolio given the very low interest rate yields of many other potential investments, as well as the volatility of the stock market in recent years – resulting in significant innovation in the type of instruments and mechanisms used to provide financing to SMEs (World Bank, 2015).

Institutional investors are thus increasingly cited as potential sources of finance for certain SMEs (OECD, 2013a). With more than USD 70 trillion in assets, pension funds, insurance companies, mutual funds, and sovereign wealth funds in the OECD, they could indeed become important players in the SME finance market (see Figure 1). Institutional investors provide funding mainly through the capital markets and invest in government and corporate bonds, as well as in equity. However, given the limited access of SMEs to capital markets, only a minor proportion of their assets are currently channelled to small firms, although precise data are not available. Investments through securitisation and covered bond issuance also usually reach medium-sized and larger enterprises, rather than small firms (Nassr and Wehinger, 2014). Experiences therefore suggest that institutional investors have the potential to play a bigger role in SME financing, but that their overall role as direct providers of funding via SME issuances appears to be somewhat limited, with the current focus remaining on larger enterprises.

Figure 1. Total assets by type of institutional investors in the OECD, 1995-2012, in USD trillion



Source: OECD (2013b). 1. Other forms of institutional savings include foundations and endowment funds, non-pension fund money managed by banks, private investment partnership and other forms of institutional investors.

At the same time, the low interest rate environment creates a momentum for retail investors to seek more exposure to SME (equity) investments, for example via crowd funding, business angel investments or through investments in publicly listed SMEs. The exposure of retail investors to SMEs through these financing instruments varies widely from one country to the other, illustrating an untapped potential for many countries. Whereas almost half of the US population invested in listed equities securities in 2013 (directly or indirectly through funds), only 13.8% of Germans did so (OECD, 2014b). Case studies illustrate that equity crowd funding is gaining considerable traction in some countries, but remains virtually non-existent in others (OECD 2015a). Collective Investments Vehicles, broadly defined as

funds offering investors the possibility to invest in groups in order to benefit from certain advantages like lower transaction costs or risk sharing, provide another channel through which individuals can invest in SMEs through the capital market. Box 2 describes the salient characteristics and market developments of Business Development Companies (BDCs), the primary vehicle for investment in SMEs through public markets in the United States as an example.

Box 2. Collective investments in the SME sector: The case of Business Development Companies in the United States

General Considerations

To date, SMEs have made only limited progress in obtaining funding through public capital markets. Nonetheless, some noteworthy success in attracting retail savings has been achieved through specialised collective investment instruments. One such instrument, that has proven highly successful in raising funds for SMEs from retail investors, is Business Development Companies (BDCs), which have enjoyed strong growth in the United States in recent years.

A BDC is a special kind of closed end fund (CEF). A CEF has an indefinite life and issues a specific number of shares at an offering price. The managers of the CEF use the proceeds of the issue to purchase assets which generate earnings for the fund. The secondary price is determined by supply and demand and shares usually trade at a discount or premium to Net Asset Value (NAV.) There is no possibility to liquidate a position in the BDC except by sale of the shares. These instruments particularly well suited to SMEs since they can function with limited liquidity and opaque prices.

BDCs invest mainly in medium-sized companies with positive earnings and good prospects of engaging in either expansion, or type of some corporate transformation, such as recapitalisation or change of control. These transformations frequently support an operation in the private equity market. Financing through BDCs (and indeed through most capital market operations) is expensive for SMEs, and therefore only suitable for a company that expects to improve its earning significantly in the medium term.

BDCs invest primarily in debt, mostly in companies that are unrated or rated below investment grade. They may concentrate on the top of the capital structure in senior secured loans, or further down on subordinated or mezzanine debt, with some equity components. Debt-focused BDCs tend to generate high current income, with an average yield of 12%, as of March 2016. Only a minority of BDCs focus on equity. The BDC receives earnings in the form of interest and dividends from its portfolio and passes those earnings on to investors. The BDC pays no taxes on its portfolio earnings, but the investors pay taxes at normal rates. The remuneration of the BDC's investment managers is high and tied to their success in generating high returns for investors. Managers usually receive 2% of Assets Under Management (AUM), as well as incentive fees when returns exceed a "hurdle rate," usually at 8%. Unlike a collective investment scheme holding liquid assets, portfolio valuation is a challenge for BDCs which hold securities that rarely, if ever trade.

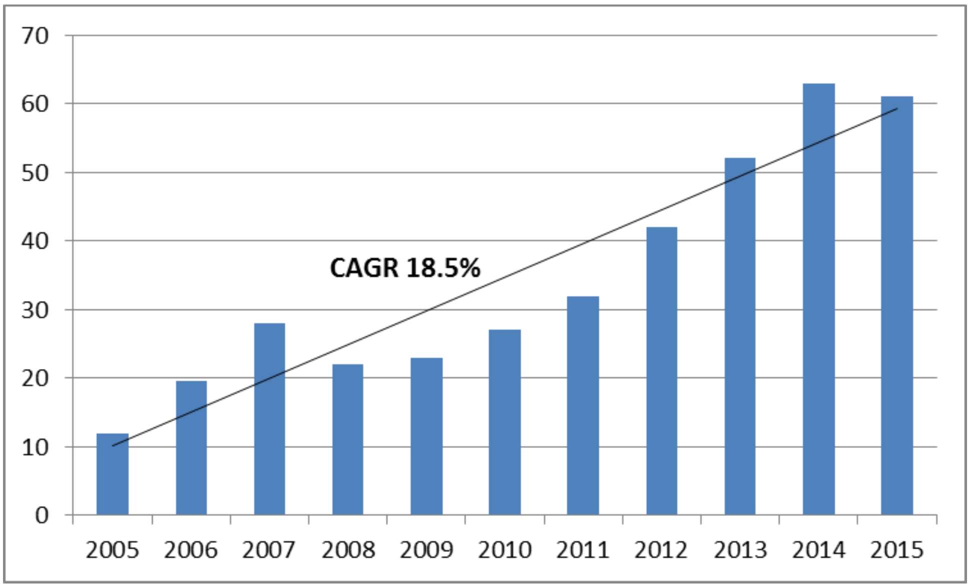
Many BDCs operate as part of broader SME investment "platforms" under a common owner. Other companies in the platform may offer private equity or debt funds, or issue "sponsored" debt in the loan market. The platform approach enables the company to use all relevant parts of the capital market to meet the firm's specific needs.

Trends in the BDC sector

Although BDCs were launched as early as the 1980s, at first only a limited volume of business took place. In 2005, there were still only 7 BDCs with a total of USD 10 billion in AUM. In 2005-07, an expansion began that was cut short by the global financial crisis. After 2010, a strong resumption of growth ensued, with the number of new BDCs and the volume of assets each tripling. The BDC sector thus began to emerge as a major source of finance for SMEs in the United States and its model was increasingly accepted in the marketplace. By 2015, there were 50 BDCs with AUM of over USD 60 billion (see Figure 2). Assets of BDCs were equal to 13% of total bank lending to SMEs (estimated at about USD 450 billion.) The success of these instruments was partly due to the lack of interest of banks in expanding lending to SMEs. Moreover, with interest rates at historically low levels, investors were attracted by the high yields on BDC investments. Additionally, few other possibilities to invest in SME were open to the public.

Figure 2. BDC asset growth, 2005-15

In USD billion



During 2015, expansion tapered off and most BDCs began trading at discounts. Discounts widened, and by late 2105 almost 4/5 of BDCs were trading below NAV. Investors may still be willing to buy BDCs at discounts in order to obtain the high current yield and to take advantage of possible narrowing of discounts. At the same time, however, there has been very little new issuance in the past eighteen months.

The success of the BDC model in recent years indicates that there is considerable scope to tap the retail market to provide finance to SMEs. The big challenge is for capital markets to develop vehicles that allow investors to obtain the high yields of investments in SMEs while dealing with the inherent problems of opacity and lack of liquidity in SME assets. The next few years will determine whether the BDC sector is simply going through a pause in its long term expansion, or whether the investment industry will find with other mechanisms to enable the public to participate in the growth of the SME sector.

Source: The BDC Universe. http://cefdata.com/bdc; Raymond James Investment Banking.

3. Challenges for the development of non-bank finance instruments for SMEs

3.1. Demand-side obstacles

Lack of awareness of the existence of non-bank sources of finance

Many sources of finance other than bank debt are simply not well known to many entrepreneurs, according to demand-side data from different countries, constituting a first impediment to the broader use of available finance instruments. A survey conducted by the Asian Development Bank shows that familiarity of trade finance products such as letters of credit, credit insurance, factoring, forfaiting and supply chain financing is limited for Asian SMEs (DiCaprio et al., 2014). A different survey illustrates that almost 40% of Dutch SME business owners are unfamiliar with factoring, and many are unaware that many assets besides vehicles could be leased, although leasing and factoring are long-existing and relatively well established sources of finance for SMEs (Panteia, 2013). Almost 60% of SMEs in the

United Kingdom are unaware of the existence of more innovative finance instruments, such as p2p business lending, p2p consumer lending, crowdfunding and invoice trading (Baeck et al., 2014).

A 2013 study, conducted jointly by BMG Research and the UK Department for Business Innovation and Skills, sheds further light on the financial knowledge of entrepreneurs. The research reveals that 95% of surveyed SMEs are aware of credit card finance. Leasing/ hire purchase is known by 85% of SMEs, but only 30% are aware of other forms of finance such as business angels, export/import finance, peer to peer lending, crowd sourcing or mezzanine finance. In the same study, 49% of SMEs would consider lease or hire purchase *if refused bank financing*, but only 16% would consider invoice finance. Similarly, many entrepreneurs are unaware of government programmes to ease access to finance for SMEs. Moreover, only a minority of SMEs seek external advice when seeking funding in the UK (such as from accountants, financial advisors, business associations, Chambers of Commerce), although those that do usually find the advice helpful.

While awareness has certainly improved over the last couple of years, only roughly half of businesses that are aware of these types of finance could name a specific supplier of that type of finance, suggesting ample scope for improvement. For instance, while 60% of smaller businesses in the United Kingdom know of the existence of venture capital as a finance type, only 22% are aware of a specific fund to approach. Similarly, peer to peer lending is known to 40%, but only 19% are aware of a specific platform. More importantly, however, is that increasing awareness has apparently not translated into higher use of these alternative sources of finance. For instance, only 1% of UK businesses had used equity finance, and only 1% had used finance from a peer to peer lender in the previous three years (British Business Bank, 2016).

The general picture arising from these studies is that SMEs and entrepreneurs go to their main bank only right before they are in need of external finance and accept any given offer, unaware of non-bank financing sources and even of potential offers of rival banks, mostly without consulting external advisors.

Perceived or real inability to access alternatives to bank lending

At the same time, it does not appear sufficient to increase awareness of the existence of non-bank financial instruments to guarantee their increased use by SMEs. Even when entrepreneurs are aware of the existence of non-bank sources of finance and would like to access them, a lack of confidence in seeking and successfully attracting alternative sources of funding might be holding them back. The 2015 SAFE survey indicates that around two-thirds of surveyed SMEs in the EU 28 reported that they felt confident discussing with banks about accessing finance and obtaining desired results, while around 22% did not. However, only 20% of SMEs felt confident in discussing financing and obtaining the desired results with equity investors and venture capital enterprises. 33% reported that they lacked confidence in that area, while the rest did not find the question applicable to them, strongly suggesting that SMEs find equity investors more intimidating to approach than commercial banks. According to the 2013 survey, only 24% of SME managers who found equity financing relevant considered that there were no barriers to acquiring this type of external funding. The high perceived cost and the unavailability of equity financing constitute the two most frequently reported barriers. That being said, it is important to note that innovative SMEs felt significantly more confident in accessing equity finance (European Commission, 2013).

Equity-type instruments indeed require a higher level of financial sophistication on the part of the business owner or entrepreneur seeking finance. Professional equity investors usually need an elaborate and detailed business plan, in-depth financial information and seek investments that comply with their due diligence requirements, which may pose difficulties to some entrepreneurs and business owners. In

the literature, this is referred to as investor-readiness. Investor readiness can be defined as "the capacity of an SME or entrepreneur – who is looking for external finance, in particular equity finance- to understand the specific needs of an investor and to be able to respond to those needs by providing an appropriate structure and relevant information, by being credible and by creating confidence" (European Commission, 2006). Although this issue is related to the dearth of credit information, investor readiness goes beyond the disclosure of financial data and also captures the issue of maturity of proposed business projects, the ability of entrepreneurs to meet due diligence requirements of professional investors, the viability of the business plan, as well as the overall capacity to successfully communicate the business project.

In an overview of the literature on investor readiness programmes, Mason and Kwok (2014) conclude that "there is considerable evidence, particularly amongst the business angel community, that investors are frustrated by the low quality of the investment opportunities that they see and so are unable to invest as frequently or as much as they would like." The authors further note that the high rejection rate of business angels and venture capitalists reflects SMEs' general inability to meet the requirements of professional investors when seeking external finance.

Within this context, the corporate governance of SMEs can also play a role in their degree of investor-readiness. Although the concept of corporate governance is usually associated with large enterprises with a dispersed ownership structure, often listed on a stock market, certain principles are of relevance for SMEs as well, and adherence to them would contribute to the investor-readiness for professional investors. This is for instance echoed by a recent OECD report, which illustrates the importance of good corporate governance for access to capital and greater financial flexibility, in particular for forward looking growth companies that have a need for long-term investments, but often possess an increased risk profile. Against this backdrop, the G20/OECD Principles of Corporate Governance can provide guidance in a number of important areas, such as the rights of shareholders, institutional investor practices, the functioning of stock markets, the role of stakeholders, corporate disclosure, the responsibilities of the board of directors, as well as the quality of regulatory supervision and enforcement (OECD, 2015c).

Poor governance of SMEs may thus explain to some extent why these firms face particularly difficult financing conditions. For example, mentoring and networking may be critical to the development of high-tech SMEs so that knowledge transfer can take place between those who have successfully developed new businesses and those who are just starting them. However, many firms at such an early development stage simply lack the resources and knowledge on how to build the necessary structures and this capacity internally.

Negative perceptions about costs and benefits of alternative financing instruments

Compared to traditional bank lending, financing sources other than straight debt are sometimes considered costly and their application process lengthy and cumbersome. According to a recent Grant Thornton LLP industry survey conducted in the United Kingdom, for example, perceptions towards non-bank lenders are mixed; although the views towards non-bank lenders among business owners are generally positive, a sizeable minority would not consider turning to non-bank lenders because they view them as being expensive, as imposing tight conditions on accessing finance, and thus only suitable for enterprises in distress who are cut off from bank lending, despite the complementarities of straight debt with other sources of finance (Grant Thornton, 2014).

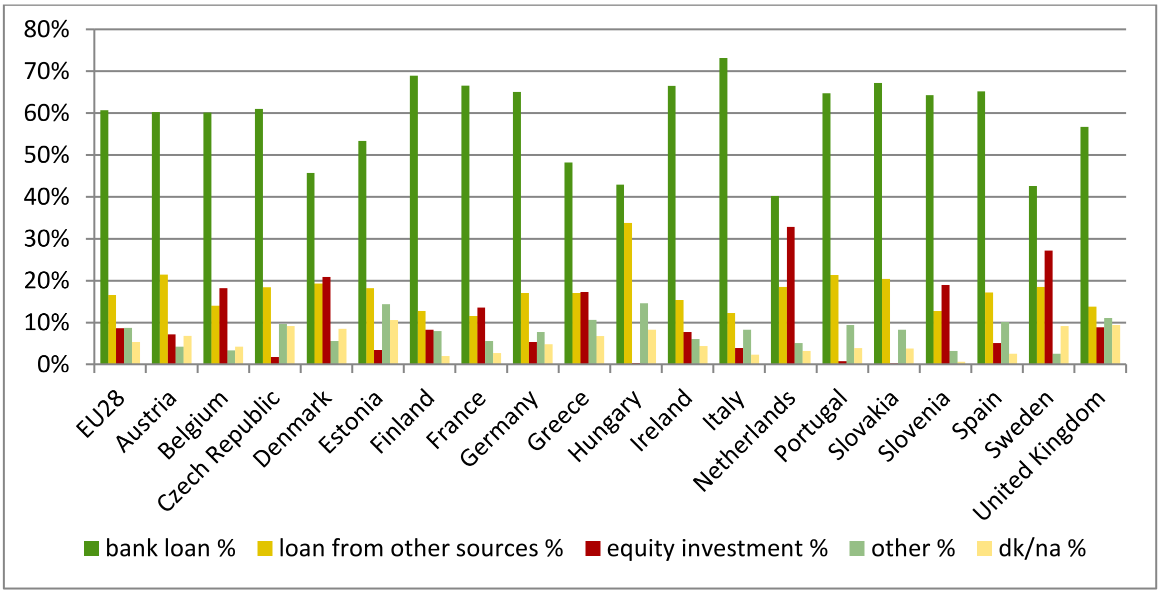
Equity-type instruments, in particular, face important hurdles in this area. Equity investors usually want to be actively involved in how the business is run. Although the involvement of professional investors

can benefit the operation of the enterprise, many small business owners are reluctant to relinquish control of their company or share business information with competitors in return for an investment in equity, potentially holding back the growth of these businesses and/ or making them over-reliant on debt finance. A survey by the Business Development Bank of Canada (BDC), for example, shows that 63% of surveyed business owners are not open to adding shareholders when securing finance and 83% are not open to the idea of losing majority control of their business. This is not due to an abundant supply of finance options, as a majority of respondents also state that obtaining finance remains difficult and believe this to be a barrier to the execution of their planned projects (BDC, 2013). This is further supported by a large-scale IOSCO study, which lists “Family owned structures and fear of losing control of the company” as the main reason why SMEs are reluctant to seek funding through the capital market is, given that post-listing, issuers may for instance have to alter their business approach, i.e. the way expenses and profitability are handled, among other things (IOSCO, 2015).

This observation confirms the so-called ‘pecking order theory,’ first pioneered by Myers (1984), which postulates that firms, especially smaller ones, have a preference for funds generated internally, and, if this does not suffice to realise the business plan, for debt instruments. Private equity is the least preferred source of finance, according to this theory. As a consequence, many firms prefer to grow at a slower pace, or even not at all, if growth would require securing equity finance and thereby losing control of making business decisions.

The 2015 SMEs’ Access to Finance Survey (SAFE) by the European Commission also provides strong evidence for this theory. Most SMEs prefer internal financing that is considered to be less expensive and not based on financiers’ terms and conditions. Among SMEs in need of external financing, a total of 61% preferred bank loans over any other source of external financing, and another 17% preferred other sources of debt financing such as trade credit or loans from related companies, shareholders or public sources. Only 9% of all respondents from this large-scale survey named equity investments as their most preferred source of external finance. These percentages have remained roughly constant between 2009 and 2014, and only increased slightly during the latest SAFE survey from 7% in 2014 to 9% in 2015, leaving equity financing the least preferred source of external finance for SMEs with growth ambitions in almost all countries in the EU 28 (see Figure 3).

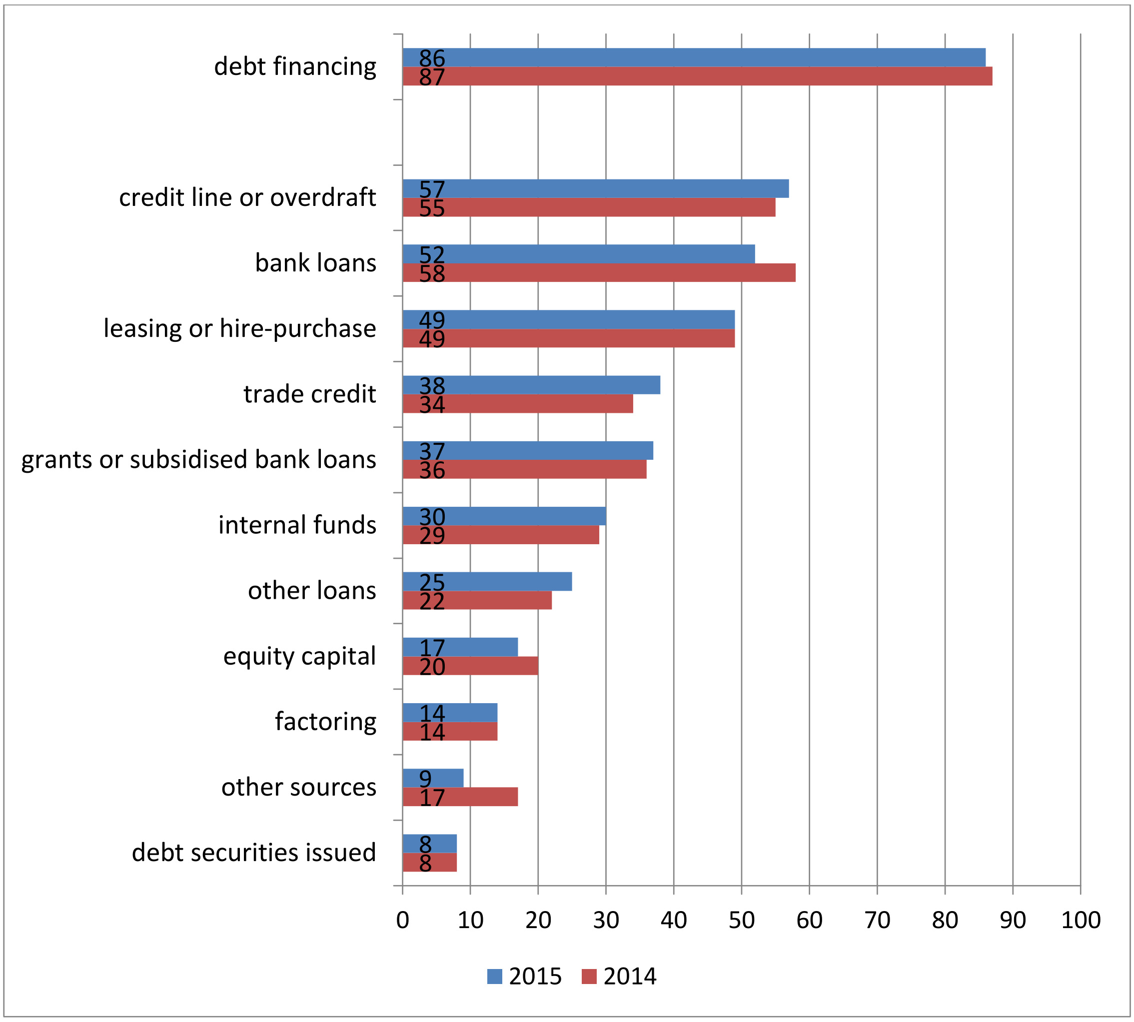
Figure 3. The type of financing EU 28 SMEs prefer for realising their growth ambitions, 2015



Source: European Commission, 2015.

Only 17% of SMEs surveyed between September and October 2015 in the EU 28 considered equity financing as relevant for their business, i.e. had used it in recent years or were considering doing so, a share significantly smaller than for most other sources of finance at their disposal. Similarly, only 2% of survey respondents had actually used equity financing of some sort in the past six months (see Figure 4). Both, the relevance and actual use of equity financing was positively correlated with firm size and their level of innovativeness. Looking at different SME types, gazelles preferred equity investment the most (13%). Overall, however, the low preference for equity financing does not vary significantly across sectors, firm size or their level of innovativeness (European Commission, 2015).

Figure 4. Relevance of financing types for SMEs in the EU 28, 2015



Source: European Commission, 2015.

Lack of financial skills and vision

In contrast to large enterprises, small businesses usually lack the resources to hire a dedicated financial professional. The business owner, who therefore usually makes financial decisions, often misses

financial training or qualifications. Although the financial knowledge of business owners and entrepreneurs on the use of financing instruments is currently underexplored, there is some evidence that their financial knowledge is limited. Against this backdrop, the OECD International Network on Financial Education (INFE)[1] recently submitted a progress report on Financial Education for Micro, Small and Medium-sized Enterprises (MSMEs) and Potential Entrepreneurs which was welcomed by the G20 Global Partnership on Financial Inclusion (GPFI) in September 2015, in acknowledgement of the fact that financial education has a broader role to play in supporting SME access to finance by encouraging sustainable entrepreneurship and by increasing levels of financial literacy. The report summarises the main components of a new work stream within the network that seeks to concretely outline which specific issues financial education support for small enterprises should address, how education programmes may fit into national policy frameworks, identify appropriate target groups, scope and delivery methods, and develop targeted tools, in particular an internationally comparable, SME-tailored questionnaire, that can help policy makers better address existing gaps (OECD/INFE, 2015).

The state of financial literacy and financial awareness of students, households and consumers has been well documented, both for developed and developing countries (see, for example, Xu and Zia, 2012, OECD, 2014c, or Lusardi and Mitchell, 2014, for an overview). These studies consistently show, for example, that many people do not understand basic financial concepts such as compound interest rates, the effect of inflation on investments, or the appreciation of risks and the importance of risk diversification. In the 2008 edition of the Bank of Italy's Survey on Household Income and Wealth (SHIW), less than one in four surveyed heads of households was able to answer three relatively simple questions measuring their competencies and financial knowledge. Among the subset of entrepreneurs and managers of firms with less than 100 employees, 47% answered all three questions correctly, suggesting better than average, but far from perfect financial knowledge among this group.

Recent evidence from Canada appears to support this assumption. More than one-third of surveyed Canadian entrepreneurs of small businesses failed a relatively straightforward financial literacy test by Intuit Canada, a developer of financial management and tax preparation solutions for personal finance and small business accounting. For example, 27% of the respondents could not correctly identify that permanent assets are needed to meet a firm's long-term needs, and more than half of all business owners of enterprises with more than five employees believe that financial training would make them more profitable (Intuit Canada, 2014). Similarly, the vast majority of UK SME managers has received no financial training and is not financially qualified, according to the 2013 SME Finance Monitor. Anecdotal evidence suggests that entrepreneurs and SME managers without a financial background struggle with the financial aspects of running their business, and that the lack appropriate financial knowledge constitutes an impediment to access finance and, more generally, to develop their business (BDRC Continental, 2014).

The shortcomings in entrepreneurs' financial literacy are a main cause of the overreliance of many businesses on overdrafts, short-term bank credit and credit card debt, even when other finance instruments might be more appropriate. These weaknesses may also lead to the misuse of costly financial products. For example, derivatives are widely used by Italian SMEs, mainly to cover interest rate risks by firms that have less balanced financial structures (i.e. are over indebted and/or insufficiently liquid) and are less profitable. Survey data suggest that many SMEs bound by derivative contracts are not adequately informed of the risks involved (Visco, 2015). In the United Kingdom, the Financial Conduct Authority

[1] The OECD International Network on Financial Education (INFE) was created in 2008 and seeks to facilitate international co-operation between policymakers and other relevant stakeholders on financial education issues. It serves as a platform to collect data on financial literacy, develop analytical and comparative reports, research, and develop policy instruments.

(FCA) reported "serious failings in the sale of IRHPs to some small and medium sized businesses" in 2012, where up to 60 000 loans that contained complex interest rate derivatives, could be classified as "mis-sales". The Dutch financial regulator made a similar assessment of 17 000 SME loans containing complex derivatives.

In addition, the lack of financial knowledge frequently limits entrepreneurs and business owners to make full use of available government support. A recent survey conducted among UK SMEs indeed shows that government initiatives usually only reach a minority of businesses, and often only those who are already relatively well-informed about potential alternatives to straight debt. Micro firms in particular, were found to be generally unaware of the existence of government finance schemes and how to access this type of funding, suggesting that these schemes could be promoted better. Accordingly, the study also indicates that those firms that felt they were more aware of government schemes tended to be from larger businesses that had higher levels of expertise in accessing finance – underlining once more that micro businesses seem to be at a particular disadvantage with regard to their ability to mobilise and allocate resources to finding the optimal financing source for their business (BMG Research/UK Department for Business Innovation and Skills, 2013).

Even when entrepreneurs and business owners are actively seeking and using non-bank sources of finance, the use of financial techniques is not always well aligned to their business needs, which depend on the life cycle of their business, the sector in which they are active, the current sources of finance, their business model and so on. An optimal use of financial instruments requires an understanding of the financial needs of the business, of the benefits and risks of potential finance sources and of their complementarities. It also requires a strategic approach to reconcile long-term financial needs with the supply of finance that is available.

Studies suggest that this financial knowledge, and indeed the overall strategic long-term vision that is required in this respect, is often absent. SMEs often do not engage in systematic and strategic planning with regard to the firm's long-term future, despite evidence that this negatively affects firm performance (Wang et al., 2007). Among the possible explanations are the aspirations of business owners, who might value non-tangible benefits such as autonomy, lifestyle and personal satisfaction more than the maximisation of profits or other priority objectives more or less related to the firm's impact or performance. Another theory focuses on the limited resources SMEs have to engage in long-term planning, either financial or otherwise.

Tax treatment of financial instruments other than straight debt

Ideally, a country's tax system should be neutral with regard to its impact on business decisions, including the creation, form and growth of SMEs. However, a 2015 OECD study on the taxation of SMEs found that many of the examined tax systems included certain features that inadvertently put SMEs at a disadvantage relative to larger enterprises. These features included the asymmetric treatment of profits and losses, as well as higher fixed costs associated with tax and regulatory compliance regimes (OECD, 2015b).

A further key issue identified in the 2015 OECD study, as well as in other papers, refers to the existing tax bias towards debt over equity, which in combination with other factors such as lower liquidity, affects SMEs more than large enterprises. While businesses can usually deduct interest rate payments paid on bank loans and other forms of debt, returns on equity such as dividend payments to shareholders generally cannot be deducted. Evidence suggests that the disincentive this creates to attracting equity

financing can be quite substantial. An investment made in a corporation in the United States[2], financed entirely by equity, would face a marginal tax rate of 33% on average, according to a recent study by the Kauffman foundation. The effective marginal tax rate for a similar investment financed completely by debt is -6%, meaning that new investments by debt are actually subsidised by the tax system (Rosenberg and Marron, 2015). In the European Union, debt-financed investments typically bear a negative effective marginal tax rate as well, while equity-financed incentives are taxed to varying degrees, resulting in a similarly pronounced gap in the effective marginal tax rate (Fatica et al., 2012).

A meta-analysis of 267 estimates from 19 peer-reviewed studies illustrates that this "debt bias" significantly impacts the financial corporate structure. A one percent higher corporate income tax rate increases the debt-equity ratio by between 0.17% and 0.28%. In other words, a country with a corporate income tax rate of 36% that would fully eliminate the corporate tax advantage of debt would see the average corporate debt-asset ratio fall by 10% (de Mooij, 2011). Evidence suggests that the high levels of leverage increased systemic risk and aggravated the recent financial crisis (Fatica et al., 2012). With limited access to equity financing and a limited availability of debt finance and the terms upon which it is granted to small firms, especially in the light of the existing tax bias and certain other features in the tax system, SMEs ultimately end up facing greater costs in accessing a more diverse set of funding instruments than their larger competitors (OECD, 2015b).

3.2. Supply-side obstacles

Opacity of the SME market

There is currently a serious information deficiency in financial markets and one of the main difficulties faced by SMEs in accessing financial markets in that respect is the lack of credit information. SMEs are known to be opaque, often lacking audited financial statements or other credible credit data that would allow investors to reliably assess the risks and potential benefits from investing in them. Moreover, the data available are not always standardised and therefore not easily comparable, partly because SMEs are inherently diverse and their characteristics relatively hard to capture in a few quantitative indicators. This creates a problem of adverse selection, where lenders and investors in SMEs are unable to differentiate between low-risk and high-risk borrowers, as well as one of moral hazard, whereby borrowers possibly change their risk-taking behaviour after receiving financing.

Assessing the creditworthiness of a business is costly, and these costs do not scale up linearly with the size of the enterprise or its financing needs. While large companies are usually subject to disclosure requirements, governance rules and other obligations that make collection of information and the assessment of their credit worthiness an easier task, this is most often not the case for SMEs, which, in turn, end up having little access to securities markets, for instance. Firms with relatively modest financing needs are therefore most at risk of being excluded from the banking sector and from financial markets.

This reflects the likelihood of information asymmetries between borrowers and lenders where it may be costly or difficult for lenders to secure the information they need to make an informed investment decision, as well as other structural issues. This applies to small businesses at all stages of development, whether they are starting-up, scaling-up or seeking finance to stay-ahead in their particular area of the

[2] That is a corporation that is taxed separately from its owners according to the United States federal income tax law.

market. These information asymmetries are a prime reason why small and medium-sized enterprises are often denied credit or other forms of external financing (World Bank, 2014a).

Given the currently deficient state of information provision for the purpose of financing SMEs, there is room for improvement and opportunities for innovation, so as to support the development of a market for corporate financing that complements the traditional banking channel. Although most developed countries have adopted the standards developed by the IFRS Foundation with respect to financial reporting statistics, there are differences across countries with respect to the availability of these data and how these standards (and general accounting principles) are loosened for SMEs, when they are considered to be overly costly or cumbersome for small firms (World Bank, 2014c). Against this backdrop, the G20/OECD High Level Principles on SME Financing emphasise the importance of improving transparency in SME finance markets by making credit risk information on SMEs more accurate and accessible to all relevant market participants.

Limited exit options

The existence of exit options implies, broadly speaking, a way for investors to at least repay, but ideally convert their initial investment in a company into profit. The current lack of available exit options in some equity markets indeed represents another critical factor that further impacts SMEs' access to certain financing instruments. The issue of exit is of particular relevance within the business angel and venture capital community, where investment decisions are partly determined by the need for exit possibilities. The practitioner community has indeed identified the difficulty in achieving exits as among the most pressing problems for investors. Angel investors notably state that there is now a major problem in achieving timely exits, with the length of time to exit having risen considerably in recent years, reportedly from three years in 2005 to about ten years or more in 2013 (Mason and Botelho, 2014). Such long time horizons hold back angels from re-investing in new companies and are also likely to be a source of concern for existing and potential new angels.

A 2015 study by the EIF shows that the two main exit routes today take place in the form of trade sales, where the company shares are sold to another firm, or in the form of an initial public offering (IPO), where the company shares are sold to the public. Indeed, trade sales together with sales to another private equity house together account for more than half of the volume of total divestments in 2014. The share of public offerings also increased considerably, to more than a quarter of all divestments in the first three quarters of 2015, due to significantly stronger sales of quoted equity. As regards overall private equity, available data show that the relative importance of write-offs has decreased continuously since 2010, except for a slight increase in 2013 (EIF, 2015). In this regard, illiquid capital markets, in which venture capitalists find it difficult to sell their shares or engineer an M&A, as was the case in the aftermath of the financial crisis, represent an impediment to VC expansion and the uptake of such instruments by SMEs (OECD, 2015a).

The growth of co-investment funds around the globe as a means of addressing supply-side gaps in the availability of start-up and early growth capital suggests that achieving exits has indeed also become a significant issue for governments, especially since such funds are intended to be evergreen. Yet, while vibrant stock markets are critical for successful IPOs and the development of the venture capital market, it is not always clear how policy can encourage exits (OECD, 2016). Programmes aimed to boost the availability and uptake of certain alternative sources of finance for SMEs will probably continue to struggle with raising interest from investors as long as there are few ways to realise a profit and sell the investment. Timely exits with positive returns on the other hand are likely to attract new potential investors and generate liquidities for further investments; they are thus a major determinant of a vibrant entrepreneurial ecosystem (Mason and Botelho, 2014).

Regulatory ambiguity or barriers to entry in the SME market

The regulatory and prudential framework is a crucial enabler for the successful development of alternative finance instruments. Financing techniques further along the risk-return spectrum are particularly stymied by asymmetric information between suppliers of finance and their potential beneficiaries. Platforms for public listings of SMEs are a prime example of a source of finance for which it is critical to find the right balance between guaranteeing investor protection and good corporate governance, and providing sufficient transparency to all market participants, while at the same time not overburdening SMEs with high costs, due diligence requirements, and administrative and regulatory burdens. Within this context, a recently conducted survey among European and US investors found that the current growth problem European SMEs face may be much more related to rigidity in regulatory rules in Europe, than with access to finance as such, suggesting at least that the importance of regulation for SME access to equity instruments in particular may have, up until now, been somewhat underestimated (AFME/ Boston Consulting Group, 2015).

Moreover, large cross-country differences in the regulatory environment persist, which directly impact the development of finance instruments alternative to straight debt. In recent years, the legal framework on crowdfunding has been established or revised in countries as varied as Austria, Korea and the United States, with large differences in the regulatory approach, while crowdfunding activities remain unregulated or partially regulated in other OECD countries, such as Australia and Israel. Whereas Mexican pension funds are not allowed to invest in equities, other countries are stimulating their pension funds to invest in domestic SMEs. Denmark, where pension funds have been allowed to allocate risk capital to innovative SMEs since 2011, and where three of the largest pension funds have recently set up a fund to provide subordinate loans to domestic SMEs, is a case in point (OECD, 2016; 2014a).

In recent years, the emergence of FinTech – a term composed of the words “finance” and “technology”, and broadly defined as the use of technology and innovative business models in financial services, including banking and corporate finance, capital markets, and financial data analytics, but also payments and personal financial management – has become a powerful trend. From 2013 to 2014, equity investment into FinTech companies tripled from USD 4 billion to more than USD 12 billion (World Economic Forum, 2015; Accenture, 2015). Because FinTech solutions are considered efficient and effective at lower scale, offering a new set of products tailored to the needs of small businesses, such as marketplace (p2p) lending, merchant and e-commerce finance, invoice finance, online supply chain finance and online trade finance, these firms are expected to be the main beneficiaries (see Box 3).

However, regulation setoff FinTech has yet to be developed in most countries. As a result, platforms in many jurisdictions have initially started to operate in a “grey area”, given that dedicated marketplace lending legislation was not yet in place. The question of if and how fast FinTech players may replace traditional business models therefore critically depends on the role that regulators, governments and international organisations choose to play. The legal and regulatory environment would need to be supportive or, at the least, not prohibitive to the business model of marketplace lending. A balance needs to be found that allows new developments in the financial sphere, while subjecting these activities to appropriate oversight and regulation to avoid regulatory arbitrage.

Box 3. FinTech and the changing lending scene for SMEs

Compared to corporate business and retail customers, small and medium-sized firms have traditionally had greater difficulties in obtaining a bank loan. At the same time, banks will for the foreseeable future remain the first choice for SMEs looking for funding. Within that context, the FinTech industry may have the potential to correct some of the currently existing market failures and help lower costs for banks (but also for other potential lenders) attached to obtaining information about possible SME clients, provide alternative channels to reduce service delivery costs (e.g. via cell phones, cards, internet), as well as support small firms in better managing their business through real-time, more affordable services.

In contrast to banks, FinTech companies often rely on social media reviews, mobile phone or aggregated disparate sources of data, such as a companies' usage of logistics firms, to conduct credit risk assessments. This kind of data-driven lending has certain advantages over decisions based on a single credit score or meetings between banker and client. FinTech proponents put argue that humans are more prejudiced than algorithms, potentially resulting in bias against certain groups, such as female or migrant entrepreneurs. Moreover, the cost of relationship lending tends to encourage bankers to favour big customers over small ones. For young businesses and borrowers on the fringes of the banking system, risk assessment that scours the online world for information may thus be a better fit than a loan officer in a branch. Moreover, the digitalisation of financial services increasingly allows for businesses and investors to meet directly and essentially cuts out intermediaries involved in equity sales today, thus making access to finance faster.

In recognition of the potential offered by FinTech, the lending market includes an increasing number of innovative new players helping businesses to obtain financing, including the following:

- Lenddo is a Hong Kong-based company that assesses loan applicants by looking for instance at the number and nature of Facebook and Linkedin contacts, as well as borrowers' social media content (posts, photos, likes). In addition, it asks contacts to vouch for the creditworthiness of loan applicants. The company currently uses this social media data to underwrite small, short-term loans in Mexico, the Philippines, and Colombia.

- AngelList, a US website launched in 2010 and one of early players in the crowdinvesting space, has developed into an early stage community where entrepreneurs may seek connections with suitable investors. Simultaneously, job-seekers may be hired by promising young start-ups. The site also allows start-ups to raise money from angel investors free of charge.

- In the field of P2P lending, online-only start-ups like Unbolted and Ratesetter, both UK-based, provide a simple and fast opportunity for borrowers to receive immediate funds against their personal assets, in complete privacy, thus avoiding having to spend the usual weeks or even months it can take traditional lenders to make a decision on a loan.

FinTech companies are now actively integrating technologies and products for merchants, such as alternative capital sources (crowdinvesting, p2b-lending), mobile banking technologies, tablet-based cash registers, POS management systems, cloud accounting and payroll services. As SMEs continue to expand into non-traditional sectors, it is likely that an even greater proliferation of FinTech services will occur so as to cater to this growing market. FinTech may thus have the potential to contribute to improving lending to SMEs via such innovative financing products and/ or approaches to finance.

Source : The Economist, 2015; Life.SREDA VC, 2016; Prodigy Finance, 2014.

3.3. Looking beyond demand and supply: Fragmentation of financial markets for SMEs

As a result of the demand- and supply-side hurdles described above, financial markets for SMEs often remain fragmented and underdeveloped. The small scale and liquidity of these SME markets further limits the interest from potential entrants, most notably professional investors. This, in turn, limits the

entrance of intermediaries and other participants in the financial ecosystem (such as brokers, market-makers, advisors, researchers, platforms). Available evidence suggests that start-ups in particular face significant problems in raising equity finance for early-stage development which are unlikely to be caused purely by a market failure in the supply of capital. Instead, the limited overall selection effect coupled with the prevalent equity style behaviour, where firms are mostly funded above a given threshold; suggest that there is a fragmented market with respect to the supply of critical resources. Regarding finance, this results in constraints on funding usually being at higher levels (mostly at EUR 300 000 or more), while for smaller investments there even seems to be an overlap between different instruments and overall few suitable firms to invest in (Mason and Botelho, 2014). These critical resources extend beyond finance, however, and also include, for instance, managerial expertise (in both recipient firms and VC funds), as well as sufficient availability of high-quality, investment-ready firms and projects.

The existence of a systemic problem is echoed by a 2009 Nesta/BVCA report, which argues that the prevalent ineffectiveness of capital markets for young, high impact firms goes beyond the difficulties associated with the supply of or demand for finance. Rather, another central concern is what the report labels a so-called ‘thin market’, where a limited number of investors and entrepreneurial high-growth firms have difficulty finding and contracting with each other at reasonable costs. This friction in the market can lead to inefficient matching, and consequently, to an economically inefficient allocation of equity finance to these firms. The report also argues that a considerable time lag may be involved before certain policy measures intended to address this issue start bearing fruits, since an emergent VC industry is initially very fragile and usually requires its constituent parts to be working effectively together for extended periods of time in order to build human capital and investor confidence. This sometimes requires decades of experience and public support, even with well-established venture capital systems, as in the US, still remaining highly sensitive to economic shocks (Nesta/BVCA, 2009). It is therefore important to keep in mind that demand and supply factors interact in a complex way with each other and frequently create dynamics of their own that need to be addressed in a smart and farsighted manner.

The need for a more integrated long-term perspective with regard to the relationship between so-called ‘growth companies’, their access to capital markets and corporate governance is also acknowledged in a recent OECD report: “*But growth requires investment and long-term investment requires patient capital. It is therefore essential that companies that have the potential to grasp commercial opportunities of scale and scope have access to equity capital. The reason is that, compared to other forms of funding, equity capital allows companies to undertake forward looking investments with uncertain outcomes in tangible as well as intangible assets, such as research, development and innovation*.” (OECD, 2015c, p.4)

A more holistic view of SME access to finance thus implies looking beyond the dichotomy of demand and supply, and acknowledging that the interplay of both structural and cyclical variables is complex and often difficult to disentangle. Considering for instance the relevance of the exit issue for certain equity markets and the magnitude of the problem in some regions, this is a necessary area for attention when designing policy measures. Of further note is that some of the barriers outlined above also impede the development of a securitisation market for SME products, which might otherwise be able to channel significant resources from institutional investors towards small and young businesses, and allow the banking sector to step up lending in an indirect way. The lack of transparency with respect to credit data and the difficulties to standardise products contribute to explaining why SME assets make up only a very small fraction of the overall securitisation market (Nassr and Wehinger, 2014).

4. The role of public policy in fostering markets for SME finance

Policy makers are increasingly aware of the need to encourage non-bank finance instruments. In the aftermath of the financial crisis, most of the policy attention focussed on sustaining bank finance, most often by expanding and/ or improving existing credit guarantee schemes or developing new ones. Although these initiatives provided necessary breathing room for many SMEs in need of finance, they also contributed to perpetuating SME over-reliance on straight debt. While policies to facilitate bank lending have often remained in place and are in many instances now being modified in line with evolving needs, an additional recent policy shift towards alternative finance instruments can be discerned. Indeed, over the last few years, many new initiatives to foster sources of finance other than straight debt have been introduced, notably with respect to equity-type instruments and a focus on innovative and high-potential SMEs. These initiatives range from introducing tax incentives for investors in SME markets, the implementation of more effective regulation (of particular note in this respect are the recently adopted regulatory frameworks for crowd financing activities in several countries), to the exploration of public-private partnerships for equity investments. Transnational initiatives have also been undertaken to support the development of a diverse range of financing options for SMEs (see Box 4).

Box 4. The Capital Markets Union - a pan-European approach

On a transnational level, the Capital Markets Union (CMU) represents a pan-European approach with the aim of supporting the development of alternative sources of finance complementary to bank-financing, and to thereby better connect SMEs with a wider range of funding sources at different stages of their development, as well as to ensure that capital can move freely across borders in the Single Market.

On 30 September 2015, the Commission adopted an Action Plan on a CMU. The Action Plan sets out a programme of 33 actions and related measures, which aim to establish the building blocks of an integrated capital market in the European Union by 2019. This includes in particular the launch of a package of measures to support venture capital and equity financing and promote innovative forms of business financing, such as crowd-funding, private placements, and loan-originating funds in the EU. In addition, the Plan comprises measures for catalysing private investment using EU resources through pan-European funds-of-funds, regulatory reform, and the promotion of best practice on tax incentives.

Source : European Commission

Such developments demonstrate that SMEs remain high on the political agenda. The OECD is currently supporting governments in their implementation of the G20/OECD High Level Principles on SME Financing (see Box 5), including the development of effective approaches to implement the Principles in individual countries, and monitor their implementation.

Box 5. G20/OECD High Level Principles on SME Financing

1. Identify SME financing needs and gaps and improve the evidence base
2. Strengthen SME access to traditional bank financing.
3. Enable SMEs to access diverse non-traditional financing instruments and channels
4. Promote financial inclusion for SMEs and ease access to formal financial services, including for informal firms
5. Design regulation that supports a range of financing instruments for SMEs, while ensuring financial stability and investor protection
6. Improve transparency in SME finance markets
7. Enhance SME financial skills and strategic vision
8. Adopt principles of risk sharing for publicly supported SME finance instruments
9. Encourage timely payments in commercial transactions and public procurement
10. Design public programmes for SME finance which ensure additionality, cost effectiveness and user-friendliness
11. Monitor and evaluate public programmes to enhance SME finance

The rationale for public policy to take an active role in removing barriers to the development of alternative finance instruments for SMEs is two-fold. First, the financing gap faced by SMEs has been widely identified as stemming from a market failure, resulting in economic inefficiencies and meriting public intervention. A second argument for intervention relates to the positive spill-over effects that the development of alternative finance instruments generates for the broader economy, especially those targeting fast-growing firms that contribute disproportionately to job growth. It is against this backdrop that many governments have stepped in to make alternative financial instruments more available to small businesses. The sections below provide an overview of the main types of relevant policy initiatives, many of which are in line with the G20/OECD High Level Principles on SME Financing with respect to the issues they seek to address.

4.1. Designing an effective regulatory framework

The design and implementation of effective regulation that supports a range of financing instruments for SMEs, while ensuring financial stability and investor protection, is a key enabler to the greater use of alternative finance techniques and frequently identified as an important obstacle by entrepreneurs and SMEs (OECD, 2015a). Particularly in the equity space, flexibility provided to SMEs should be compatible with investor protection, integrity of market participants, corporate governance and transparency. Achieving this balance continues to represent a challenge for policy makers and regulatory authorities, however. As an example, the reporting and credit rating requirements for private placements of corporate bonds by unlisted companies varies from one country to the other, depending on how regulators weigh the risks and benefits involved.

Against this backdrop, several countries have recently overhauled their regulation to allow for the further expansion of alternative financing instruments. Since 2012, Turkey adopted a mechanism to license business angels in order to professionalise the business angel market industry. Furthermore, it makes business angel investments an institutionalised and trustworthy financial market and eligible for state support, mainly under the form of tax deductions for angel investors. In March 2014, Chile launched a set of measures titled the "Agenda of Productivity, Innovation and Growth." One of the key initiatives on the agenda is a modification of the existing regulation related to financial instruments with the aim of increasing access of new alternative instruments of finance for SMEs and entrepreneurs.

A Belgian law promulgated in 2013 ("*Loi relative à diverses dispositions concernant le financement des petites et moyennes entreprises*") relates to credit contracts and the obligation for possible credit providers to provide sufficient and transparent advice on what kind of credit might be most suitable for a certain SME (and if the information is not well provided, the SME can later on reverse the contract). The law also includes the provision that most firms can cancel their credit contract at any time, with a maximum fine of six months interest. Although the law is limited to credit contracts, it is an example of how a government can try to make the financing market more transparent for SMEs via regulation, which may also be applicable in the context of alternative financing instruments. The Belgian government is currently gathering inputs for evaluating this law (and revising it, if needed).

Box 6. Bolsa de Productos de Chile – A public market for receivables with special investor protection

The Chilean Commodities Exchange ("Bolsa de Productos de Chile" - BPC) is a demutualised entity regulated by Law and supervised by the Securities and Insurance Commission (SVS). Its purpose is to offer public auction platforms for the trading of commodities, contracts, receivables and their derivatives. Through this initiative, Chile managed to develop a public market for receivables for the exchange of receivables issued by certain big (and certified) buyers to their suppliers which essentially works like an equity market. SMEs make use of this market to obtain cash flow advances in exchange for these receivables (just like for factoring). In fact, factoring companies themselves sell a portfolio of receivables in this market.

The establishment of *Bolsa de Productos* has been made possible because of a recent law (Law 19.220), which provides unique legal safeguards for investors that acquire invoices through the exchange, protecting them from any encumbrance that may affect an invoice. The invoices remain under legal and material custody of the BPC from the beginning of the operation to the payment by the debtor of the invoice, thus assuring that they are out of reach from potential creditors. In 2007, the law was modified so as to include invoices among the products that BPC can operate.

Advantages of this mechanism include, inter alia, the concentration of payments into one single entity, without limiting suppliers' access to the market. BPC thus supports suppliers growth, allowing them to finance their working capital at buyers risk related rates and also allows them to get better, tax-free, faster and cheaper rates for their working capital. This ultimately results in an extension of payment terms of payable accounts (DPO, days of payment outstanding) without the use of banking credit lines.

Bolsa de Productos began trading in 2005 and has operated to date over USD 6 billion in assets, growing by a compounded annual rate of 40% in receivables trading from 2012 to 2015. In 2015, BPC traded around USD 900 million, mainly from the mining and agro-industry sector, although most economic sectors are represented, along with different durations, depending on payers' economic activity. The average monthly discount rate at the exchange was approximately 0.8% (including broker fees), compared to rates over 1% from banking factorings and 1.8% from non-banking factorings. 63% of companies that sold their invoices at the exchange were SMEs. Currently, *Bolsa de Productos* has 12 operating brokers responsible for the fulfilment of the contracts agreed upon through their intermediation - most of them non-banking institutions.

Source : Bolsa de Productos de Chile (presentation at the OECD and written exchanges)

Another example of recent progress in that respect is the set-up of a number of growth markets dedicated to financing and promoting small and midsized stocks. These include London's Alternative Investment (AIM) market, AIM Italia (see Box 7), NYSE Euronext's Enternext, the Frankfurt Stock Exchange's Entry market, Nasdaq's First North serving the Nordic markets, Spain's Alternative Stock Market and Turkey's Emerging Companies Market of Borsa Istanbul. Across France, Germany, Italy, Spain and the UK, over 1 500 companies are listed on growth exchanges or multilateral trading facilities, representing nearly EUR 126 billion (AFME, 2015).

Box 7. Facilitating access to equity for Italian SMEs

Italy's equity markets have recently started to play a bigger role in funding small and medium sized enterprises. As of summer 2015, AIM Italia, a member of the London Stock Exchange Group, is hosting trading for 66 SMEs with a total value of more than EUR 2.6 billion. This dedicated market for SMEs is set to grow in the coming years thanks to a three phase programme launched by AIM in 2012, called ELITE.

ELITE is a long-term programme for SMEs that meet certain minimum growth and financial requirements and offers integrated services to help SMEs prepare and structure their businesses for continued growth and eventual equity capital markets access.

In the first two years, 150 companies from various industries in Italy, with an average turnover of EUR105 million, enrolled in ELITE. They range from Neomobile, which is just eight years old, to Marchesi de Frescobaldi, a Tuscany wine producer that traces its history back seven centuries. ELITE includes companies from areas within Italy that are traditionally not well represented in the ranks of listed firms. For example, 11 companies are based in Campania in Southern Italy.

One of the ELITE companies is already listed on AIM Italia and 15 others have announced their intention to do so. Other participants are pursuing various financing options within the programme. In 2014, ELITE was extended to the UK. Overall, as of Spring 2015, 271 European companies are participating in ELITE from Germany, France, the UK, Italy and Romania.

Source: AFME, 2015.

The updated EU Markets in Financial Regulation Directive (MiFID II) introduces specific measures designed to encourage these SME growth markets, improve SME access to equity capital and encourage development of these specialist markets (European Commission, 2014). However, AFME (2015) also signals that certain measures in the regime relating to pre-trade transparency may ultimately reduce trading liquidity, and thus make it harder for SMEs to raise equity capital.

4.2. Tax incentives

The provision of tax incentives is another widely used instrument to lift barriers for investing in SMEs. These tax incentives are usually centred on investments in equity, as debt is already favoured by most tax authorities of OECD member states, usually via tax deductibility of interest payments. Tax incentives are sometimes also directed at the demand side, under the form of support for innovative start-ups, tax deductibility of entrepreneurship training or participation in an incubator programme. According to a survey conducted in 2012 in 32 OECD countries, policy interventions in this area have expanded since the financial crisis (OECD, 2013c). In December 2013, for example, Sweden introduced a tax break for private business angel investors up to 15% of investments. Spain launched a national tax incentive scheme to encourage direct investment by third parties in small, early stage companies in 2011. Third parties investing in shares of unlisted companies are exempt from capital gains. In addition, registered venture capital companies have to pay a 1% corporate income tax in Spain (OECD, 2015b).

Several countries have experimented with the introduction of tax deductibility of notional interest paid on equity, so as to level the playing field on the tax treatment of debt and equity financing. A notional interest deduction scheme was introduced in Belgium in 2005 at the interest rate on ten year government bonds. Italy launched a similar regime in March 2012, allowing an income deduction for equity investments made after 2010 at a fixed rate of 3%. Outside the OECD, Brazil and Latvia have similar schemes in place (de Mooij and Devereux, 2014).

Turkey has recently adapted its tax regulation to make equity investments more attractive for businesses. The tax reform enabling this development has been released with the Law numbered 6 637, published in

the Turkish Official Gazette on 7 April 2015 and came into force in July 2015. From that period onwards, businesses can deduct cash capital increases from the companies' paid or issued capital amounts, or from the cash amount of the paid capital of the newly established capital companies. In addition, licensed business angel investors can deduct 75% of the capital they invest in innovative and high growth SMEs whose shares are not traded at the stock market from their annual income tax base. The 75% deduction rate will be increased to 100% for those investors investing in SMEs whose projects were supported by the Ministry of Science, Industry and Technology, the Scientific and Technological Research Council of Turkey (TÜBITAK) and the Small and Medium Enterprises Development Organisation (KOSGEB) in the last five years.

In 2010, the Portuguese Government put in place a tax relief for business angels. Business Angels can deduct 20% of the amount they invest in start-ups, with a cap of 15% of the Business Angel income tax amount. There are some restrictions in terms of start-up activities (real estate, financial companies are not eligible); investment in start-ups must be in equity, not loans; the maximum investment period is ten years; and angels cannot invest in relatives (family) companies. Similarly, in Sweden, a tax break for private business angel investors was launched in December 2013. The tax break allows for a tax relief on the capital income tax up to 15% of the investment. The regular capital income tax rate is 30%. Private individuals purchasing shares in a small company can deduct up to 50% of the investment from capital income tax owed, up to a yearly limit of SEK 650 000 and to a total maximum of SEK 1.3 million. A number of different conditions have to be met by the target firm, the investor and the investment for the deduction to be available, such as a minimum holding period of five years. Similar tax incentives exist in number of further countries (OECD, 2016).

In 2015, the Australian Government announced a suite of new tax and business incentive measures under the National Innovation and Science Agenda. The new measures include new tax breaks for early stage investors in innovative start-ups. Investors will receive a 20% non-refundable tax offset, capped at AUD 200 000 per year, as well as a capital gains tax exemption. Another new measure is the introduction of a 10% non-refundable tax offset for capital invested in new Early Stage Venture Capital Limited Partnerships (ESVCLPs), and an increase in the cap on committed capital from AUD 100 million to AUD 200 million for new ESVCLPs.

Evidence from Belgium, where the tax deductibility scheme has been in place for a decade now, suggests that this tax reform has had a pronounced impact on the debt-capital structure as the average debt ratio for Belgian SMEs declined from 0.61% in 2005 to 0.57% in 2008 (Kestens et al., 2012). A significant downside of this tax scheme, and similar ones in other countries, is its cost in terms of foregone earnings: its budgetary impact is estimated to have increased from EUR 1.8 billion in 2006 to EUR 6.2 billion in 2011. Although this estimate does not take into account the likely positive effects of the tax deduction on economic activities, the costs of tax deductibility schemes for equity investments seem to be significant and an important deterrent to their wider adoption (Zangari, 2014).

4.3. Developing a credit information infrastructure

The development of a credit risk assessment infrastructure plays a crucial role in overcoming existing information asymmetries and improving transparency in SME finance markets. Financial reporting statistics form a key source of information in this regard. Credit registries, credit bureaus and supplier networks in particular can provide information on SMEs' creditworthiness by disclosing data on the liabilities of SMEs and their repayment record. A meta-analysis of the literature concludes indeed that the existence of credit registries and bureaus is positively associated with the size of the credit market and stronger repayment performance (OECD, 2012a). Information sharing institutions take the form of either a public credit registry, generally managed by the national bank or the financial supervisor, or a

private credit bureau. Both can address the information asymmetries that are central to the reluctance of banks to lend to new clients and for attracting investors in SME markets by providing evidence on on-time payments, late payments/ arrears, defaults, bankruptcies on previous contractual financial obligations, etc.

A study from the World Bank reveals that 31 out of 34 OECD countries have a functioning credit bureau or credit registry (or both), covering at least 5% of the adult population (World Bank, 2014b). The regulatory and practical design of these institutions matter for their performance with wide cross-country differences with respect to historical information on repayments, inclusion of balance sheet data, reporting requirements and so on (OECD, 2012a). In addition, credit registries are often used for regulatory purposes rather than to provide information about creditworthiness.

A study in six European countries showed that, even within this limited subset of countries, large differences persist in the rigour and comprehensiveness of credit reporting systems. Annual accounts are often only available with significant time lags of up to 18 months, not audited and not easy to assess, partly because of privacy concerns, data protection laws and confidentiality laws. Portuguese banks, for example, can only access information on the current credit position of a potential client and not on historical data (Bain & Company and IIF, 2013).

Within this context, the Banque de France's model stands out with its FIBEN (*Fichier bancaire des entreprises*) service, gathering a relatively comprehensive set of data on SMEs. The FIBEN database integrates all available financial information about an individual firm, provides a score for a fee, and is accessible to banks operating in France. The Banque de France also performs an independent risk analysis of French enterprises, allowing banks to assess credit risks of potential clients at low costs, thereby contributing to SMEs' access to bank finance. In 2014, nearly 300 000 French companies, the vast majority of them SMEs, were covered in the FIBEN database. Credit information is, up to now, only available for banks operating in France and, more recently, also for insurance companies. Access to these data by a wider range of market constituencies, such as institutional investors, might encourage the development of alternative finance instruments. The recent experience of the Euro Secured Notes Issuer (ESNI) initiative, which aims to stimulate a SME securitisation market, illustrates the potential of FIBEN (and other similar databases) for non-bank providers of external finance to SMEs (see Box 8).

Box 8. The Euro Secured Notes Issuer (ESNI) initiative

A well-functioning securitisation market for SME assets allows banks to refinance themselves on financial markets, using SME loans as collateral. This would not only spur bank lending by transferring credit risk and relieving their balance sheet, but would also allow for SME access to the capital market and enable institutional and long-term investors to participate in SME financing on a larger scale. The securitisation of SME assets remains underdeveloped compared to other asset classes such as mortgage loans, however, in large part due to the lack of standardised and reliable data on credit risk of SME loans.

The ESNI initiative aims to overcome these information asymmetries in France by making use of both the Banque de France's credit assessment of nonfinancial companies, as well as internal ratings from banks. The ESNI was set up in March 2014 by private banking groups and with support from the Banque de France as a Special Purpose Vehicle, with the first securities issuance taking place one month later for an amount of for EUR 2.65 billion. The securities, regulatory and banking supervisory authority ensures that this scheme is compliant with existing regulation.

The provision of information from the central bank to a broad spectrum of financial institutions and market constituents on the credit quality of SME loans, complemented by internal ratings from the banking system, is crucial for the success of this instrument. It allows for issuances independent of rating agencies. The ESNI is thus a simple and transparent instrument that could potentially be replicated in other jurisdictions.

The CRD in Japan constitutes another example of a relatively comprehensive and large-scale credit risk database (see Box 9).

Source: French Banking Federation.

Box 9. The Japanese Credit Risk Database (CRD)

Japan established its Credit Risk Database (CRD) in 2001, led by the Japanese Ministry of Economy, Trade and Industry and the Small and Medium Enterprise Agency (SMEA). The CRD provides credit risk scoring, data sampling, statistical information and related services. The database therefore does not only facilitate SMEs' direct access to the banking sector, but also smoothens access to the debt market by enabling the securitisation of their claims.

The database covers financial and non-financial information, such as

- data on sales and profits,
- information on investments and inventories,
- ratios such as the operating and ordinary profits to sales,
- ratios expressing SMEs' net worth, as well as their liquid, fixed and deferred assets and liabilities,
- interest and personnel expenses, and
- default information (covering three months or more arrears, subrogation by credit guarantee corporations, bankruptcies and de facto bankruptcies).

Data on about half of all Japanese SMEs are collected and consolidated from over 50 credit guarantee corporations, government-affiliated financial institutions, and private financial institutions and then made available to CRD members who submit data to the platform.

In sum, the CRD offers high-precision scoring models constructed from its large database, to

evaluate SMEs' credit risk and to facilitate their direct access to the banking sector. Furthermore, the scoring models can also be used for loan securitisation, as well as for credit evaluation in rating pooled for securitisation. . Investors can then refer to the scores based on the models for decision making in investing securities. In addition and similar as in France, access to this database by a broader range of market participants active or potentially active in the SME finance market, could facilitate overall more investments in the SME sector.

Source: Yoshino and Taghizadeh-Hesary, 2014 and written exchanges with Japanese officials.

Privacy concerns, data protection laws and confidentiality laws limit the availability of information about credit risks to a wide range of market participants beyond the banking sector in many countries. For this reason, some alternative providers of finance such as suppliers of trade credit often do not have access to credit risk information. This, combined with the incomplete coverage and the question of reliability of information gathered on SMEs, severely restricts the usefulness of credit reporting systems for alternative providers of external finance. This contrasts with relevant data on large corporations and on individuals, which are, by and large, widely available in most advanced economies. Recently, there have been efforts in a number of countries to increase the quality of credit risk assessments and make them available to a wider constituency of market participants by proposing concrete actions that relevant authorities and policy makers could undertake to address current shortcomings (World Bank, 2014a).

Most credit registries and bureaus offer credit scoring, where information from several creditors and other sources are pooled. In short, a credit score summarises the available data in a single number reflecting the probability of repaying a debt. While credit scoring methods were originally designed to handle consumer loans, they have proven to be effective for predicting the potential delinquency of loans to SMEs. A study by the Small Business Administration (SBA) in the United States illustrates that business credit scoring has made credit more available to small businesses, especially for relatively risky loans at the margin (SBA, 2014). Credit scoring is offered in 24 out of 31 OECD countries which have a functioning credit bureau or credit registry (World Bank, 2014b).

Czech SMEs can buy a rating for around CZK 5 000 (i.e. EUR 200) at the Prague Chamber of Commerce, which is based on quantitative information and similar to a credit rating performed by large banks, and use this information to obtain finance from different sources. Peru introduced an innovative credit information scheme akin to the installation of a credit bureau, which uses a large technology platform to process and analyse repayment data held by suppliers. This platform contains reliable information on how diligently suppliers have been paid, and firms that participate in this scheme can use their past repayment record as proof of their credit worthiness and reliability, so as to facilitate access to other sources of financing.

4.4. Direct investments through funds, co-investment funds and funds-of-funds

Direct investments by governments through funds, co-investment funds and funds-of-funds have been identified as an effective and popular means of addressing supply-side gaps in the availability of start-up and early stage capital. These initiatives have become more widely used in the aftermath of the financial crisis as private equity financing dried up significantly (OECD, 2015a). If successful, these initiatives can increase the scale of SME markets, enhance networks and catalyse private investments that would not have materialised in the absence of public support. At the same time, however, some studies appear to suggest that government-backed venture capital schemes perform more poorly than their private sector counterparts (see for example Preqin Global Private Equity and Venture Capital Reports for more detailed evidence). The design of a public VC investment scheme is thus crucial for its impact. In

particular, recent evidence suggests that governmental VC schemes are more successful when they act alongside private investors, for example through governmental fund-of-funds rather than through direct public investments. Indeed, the focus of support instruments "has shifted from government equity funds investing directly to more indirect models such as co-investments funds and fund-of-funds" in OECD countries (EIF, 2015).

Israel is a remarkable success story in that respect. In the early 1990s the government set up Yozma, a programme, today frequently associated with the development of Israel's vibrant venture capital industry. Founded with a budget of USD 100 million in 1993, it initially established 10 venture capital funds, contributing up to 40% of government funds towards the total capital investment. The rest was provided by foreign investors, who were incentivised to invest in selected start-ups by risk guarantees. Nine of the 15 companies that received Yozma investment went public or were acquired and only a few years later, in 1997, the funds were privatised and the government received a return on its original investment with 50% interest (OECD, 2011).

In Denmark, Danish Growth Capital (*Dansk Vækst Kapital, DGC*), seeks to improve the access to risk capital for entrepreneurs and SMEs by creating a fund-of-funds that invests in small cap-, mid cap-, venture- and mezzanine funds. The capital base – a total of DKK 4.8 billion – has been sourced entirely from the Danish pension funds. One-quarter is invested directly in DGC by the pension funds, and three quarters are provided as a loan to the Danish public investment fund, The Growth Fund (*Vækstfonden*), which subsequently invests it for equity in DGC. This essentially creates two asset classes and alleviates the risk-based funding requirements of the pension funds. The interest rate of the loan is the government bond rate plus an illiquidity premium. Accordingly, The Growth Fund bears the risk of three-quarters of the fund-of-funds' investments.

In Chile, the development agency CORFO currently operates two programmes that support the VC industry: The Early Stage Fund (*Fondo de Etapa Temprana, FT*) and The Development and Growth Fund *(Fondo de Desarrollo y Crecimiento, FC*). The Early-Stage Fund (FT) is designed to foster the creation of new investment funds that provide high-growth, innovative small and medium sized firms with financing. The investment fund managers acquire stake in SMEs and get involved in the operations of the firm. The Development and Growth Fund (FC) programme is aimed at promoting the creation of investment funds that invest in firms with a maximum initial equity of USD 9 million with high-growth potential, which are currently at an expansion stage.

In Turkey; the Turkish Investment Initiative (TII) founded in 2007, is Turkey's first ever dedicated fund of funds and co-investment programme. TII currently has two sub-funds: The Istanbul Venture Capital Initiative (iVCi) and the Turkish Growth and Innovation Fund (TGIF). iVCi was established to provide access to finance to SMEs by acting as a catalyst for the development of the venture capital industry in Turkey through investments in independently-managed funds and via co-investments. By the end of 2016, iVCi had signed ten commitments including one co-investment, and reached a total of 64 companies. The new sub-fund TGIF will focus on investing in private equity and venture capital funds that aim to invest in SMEs which have high growth potential, high rates of return and a competitiveness advantage in their respective sector. By the end of 2016, TGIF had signed three commitments and invested in a total of three companies.

Box 10 below provides another example of a government-funded equity investment fund from the UK that recently underwent an evaluation. However, to date, there is overall little evidence concerning the effectiveness, impact and additionality of these programmes, mainly because formal impact evaluations remain relatively scarce. The OECD (2013c) has identified some key recommendations that should be considered in order for direct public funds to be successful. It is for instance crucial that these funds do

not crowd out private investments, that they are channelled through existing, market-based systems and that they aim at leveraging private sector funding. In short, they should complement private market initiatives, rather than replace them.

Box 10. Assessing the impact of the UK's Enterprise Capital Funds

Enterprise Capital Funds (ECFs) are financial schemes established by the UK Department for Business, Innovation and Skills (BIS) to address market failures in the provision of equity finance to SMEs. Government funding is used alongside private sector funds to establish funds that operate within the 'equity gap'; providing finance to small firms where an investment has the potential to provide a good commercial return.

A recently published study assesses the impact of ECFs in the UK and positively rates its overall impact, the main finding being that ECFs indeed manage to address the sub-GBP 2 million equity gap faced by young, potential high-growth businesses requiring investments, and have evolved over time so as to adapt to meet the challenges associated with changing UK early stage entrepreneurial financing requirements in the aftermath of the global financial crisis.

The UK government introduced the ECF schemes in 2006. Entailing a significant increase in the size and scale of available funding, notably with regard to the previous small-scale, public-led Regional Venture Capital Funds, this move was first and foremost intended as a concerted effort to develop private, VC-led co-investment funds. The funds require a minimum share of one third private investment and restrict private individual investment to 50% of the private funding contribution to simultaneously broaden the private investment base. Between 2000 and 2012, the BIS placed GBP 600 million in 34 VC funds, financing over 1000 businesses.

The objectives of the ECFs were mainly twofold: first, they were intended to provide gap funding for potential high-growth SMEs, mainly in seed and early stage development requiring funding between GBP 250 000 and GBP 2 million; and second, they were designed as a demonstration model for early stage institutional VCs, with the longer-term goal of establishing a UK early stage VC ecosystem that encourages new private fund managers into the market.

Particular success factors include avoidance of duplication or displacement of private initiatives in addressing the existing equity gap, along with the progressive development of innovative strategies for inter-regional and international investing that increase syndication and investor networking, diversify portfolios, spread risk, and improve planning for follow-on funding and exits. However, as also outlined in the study, while the ECF scheme aimed to establish a sustainable private seed and early stage VC market in the UK and then withdraw, persistently poor exit markets in the post-2007 period have prevented both a recycling of investment funds, as well as a signaling of widespread encouragement of private VCs into these markets. As a result, the author finds that there is currently no evidence of the scheme withdrawing, and it may be likely to have an increasing presence in follow-on investments upstream into later phases in order to generate optimal exits.

Source: Baldock, 2016.

4.5. Financial literacy programmes and the development of financial services

As the importance of financial education is increasingly acknowledged, more countries have developed measures to support financial literacy among the general population. Some 58 countries within the OECD/INFE network now have a national strategy in place to increase levels of financial literacy, consumer well-being and protection. Canada, for example, has taken the lead in this area with initiatives such as the Financial Literacy Month, the report on financial literacy and the appointment of a Financial Literacy Leader in 2014, coordinating efforts to raise financial knowledge among the population. The evaluation of the effectiveness of such programmes poses many challenges, however. Establishing a causal link (or a lack thereof) between a financial education programme and the economic decision-making of individuals, often many years later, is very hard to accomplish. More research on the cost-effectiveness of these programmes is also needed. Despite the shortcomings in evaluation methods, preliminary evidence suggests that financial counselling can be effective in reducing debt levels and delinquency rates of its beneficiaries (Lusardi and Mitchell, 2013).

Although general financial education programmes might have an effect on the financial knowledge of entrepreneurs and business owners, they do not specifically target this group. Research shows that, while

many countries have a national strategy in place to foster financial literacy, only some of them have a specific focus on SMEs, even though financial literacy needs of entrepreneurs go much beyond those of the general population. Entrepreneurs have to be able to disentangle their personal and business finances, keep records, be able to use financial statements and financial ratio's to assess the health of their business, identify and approach providers of finance and investors, have a grasp of financial risk and cash flow management, and understand the economic and financial landscape of relevance for businesses (Atkinson, 2015). This calls for an adapted curriculum in these programmes.

Some countries have developed financial education programmes for entrepreneurs and would-be entrepreneurs. Although the evidence base of the effectiveness of these programmes should be improved, most research suggests that these programmes could indeed have beneficial results and are a relatively cost-effective way to boost business performance and growth. Financial education is also often provided as part of more general services to support entrepreneurial learning, often targeted at specific groups in society such as young people or women (Cho and Honorati, 2013).

Table 2 provides some examples of topics covered in programmes that target entrepreneurs and owners of small businesses. Although there are some differences in the curricula, an understanding of financial and risk management, record keeping and compliance, along with knowledge about the main finance providers and their requirements are commonly covered (the Association of Chartered Certified Accountants, 2014). More research is required to identify the impact of these programmes as well as their cost effectiveness.

Table 2. Examples of widely used financial education curricula aimed at entrepreneurs

‘Money smart for small business’ – US FDIC/SBA	SME Toolkit – IFC/IBM	EFS/BDS model – USAID
Organisation types	Legal basics / incorporation	
Financial management	Financial management	Statements and forecasts
Record keeping	Bookkeeping and cash flow	Cash flow and financial systems
Banking services for SMEs	Finding financing	Funding options and providers’ expectations
Credit reporting	Credit and collections	
Selling a small business	Buying a business	
Insurance and risk management	Insurance	
Tax planning and reporting	Regulations and policies	
Succession planning		
Time management		

Source: The Association of Chartered Certified Accountants (2014).

Business incubators also typically help their clients to access finance, from the banking sector and beyond, and provide advice and consulting to improve accounting and financial management. In the United States, where business incubation support falls under the remit of state governments, initiatives to support the development of these institutions have proliferated since 2000 (NBIA, 2008).

Evidence indicates that complementing financial support for SMEs with non-financial elements such as counselling and monitoring provides good results. For instance, credit guarantee schemes typically offer assistance in the preparation of accounting statements and information on financial markets, and even consultancy-type services, aimed at improving firm competitiveness and productivity (OECD, 2012b). A study by the European Commission summarising results from 12 counterfactual impact evaluations, illustrates the effectiveness in combining financial innovation support for SMEs, such as the provision of grants and loans, with non-financial elements like business advice or network opportunities for the beneficiaries of the programme. Programmes that combine financial and non-financial elements thus seem to contribute to the impact of the policy initiative and to significantly improve the long-term survival chance of business start-ups (Mouqué, 2012).

Similarly, in 2013, BDC, Canada’s development bank, requested an independent, quantifiable assessment of whether the financing and consulting services it was providing actually helped accelerate the success of entrepreneurs. To this end, the bank commissioned Statistics Canada to measure its impact on clients between 2001 and 2010. Statistics Canada developed a longitudinal database of BDC clients (the “study group”) and non-clients (the “comparison group”) and then compared their performance in each year over the period. Both groups were similar in terms of age, employment, assets, debt ratio, profit margin, revenues, industry and geographic location. Statistics Canada used statistical regressions to test a series of hypotheses related to BDC’s influence on the business performance of its clients. It used five performance indicators: clients’ growth in sales, employment, productivity and profits, as well as their survival rates over the years after receiving BDC financing and/or consulting services. The statistical analysis revealed that BDC had a positive impact on all five performance indicators, but most notably when financing and consulting services were used in combination, where sales growth was 8% to 25% greater for BDC clients compared to the performance of non-clients.

In emerging economies, where informal entrepreneurship by business owners with poor financial knowledge is generally more entrenched, complementing financial support with the provision of financial education seems to work especially well. For instance, the Credit Guarantee Corporation (CGC) in Malaysia was established as early as 1972. The lack of knowledge on the working of the financial

system, the inability to produce a business plan and to make credible financial projections, or even to conduct proper financial record-keeping were quickly identified as major impediments to the successful development of businesses and the repayment of the guaranteed loan. CGC therefore also offers advisory services on financial and business development in order to help beneficiaries of their programmes make better use of their sources of finance. These advisory services on financial and business development matters were considered to be very successful and have been significantly expanded over time. In addition, the CGC offers credit information through the Credit Bureau Malaysia Sdn Bhd to collect and provide reliable credit information on SMEs and rating services that goes beyond collateral and historical financial information (Credit Guarantee Corporation Malaysia Berhad, 2012).

In addition, financial education is often provided by the private or non-for profit sector. A meta-analysis of research on the effectiveness of such programmes in emerging economies illustrates that the involvement of the private sector in government-backed programmes often increases their effectiveness (Cho and Honorati, 2013).

4.6. Investor-readiness programmes

Investor-readiness relates to meeting the requirements of external investors. A study of deals rejected by angel investors in the United Kingdom identified three main reasons why projects had been refused: weaknesses of the management team and/or entrepreneur, flawed or incomplete marketing strategies and flawed financial projections. In addition, presentational shortcomings, i.e. the construction and presentation of a comprehensive business plan, sometimes lead to a failure to access finance (Mason and Kwok, 2014). Investment readiness programmes for entrepreneurs is an area policy-makers have supported in a number of countries. The 2012 OECD financing questionnaire showed that many countries have investor readiness programmes for entrepreneurs and that, overall, support for these programmes increased between 2008 and 2012. These programmes typically focus on access to equity financing and focus on helping entrepreneurs understand the specific needs of these investors (OECD, 2013c).

France Angels was established in 2001 by five Business Angel networks. Its goal was originally to promote BA investments, to recruit new investors and to professionalise the industry. To do so, the organisation develops tools, posts them on its website available for every member, and gathers useful business documents for network management and deal flow processing. It also created a forum to quickly answer to a variety of questions. Moreover, France Angels provides national and regional support and service by creating partnership and co-investment with seed and VC funds. France Angels organises around 40 events with over 3 000 participants a year and is also responsible for collecting data on the angel market in France (OECD, 2016).

In Germany, BAND (*Business Angels Netzwerk Deutschland*) is the recognised umbrella organisation of German Business Angels and their networks, funded by the Federal Ministry for Economic Affairs and Energy. For sustained professionalisation of the German business angels market, BAND organises training events (BANDacademy) and offers practical assistance (BAND Best Practice Case and BANDquartel) in areas such as idea generation, writing a business plan, support/coaching the entrepreneur in starting up and financing, informal studies, stakeholder brainstorming, and other useful tools for entrepreneurs. Plans are underway to train the stakeholder groups – business angels, investors and entrepreneurs (European Commission, 2006).

The central aim of investor-readiness programmes is to raise the quality of investment opportunities by addressing the shortcomings outlined above. The first part of such programmes usually consists of providing information on the requirements of investors, while the second part provides concrete support

for meeting these standards (see Box 11 for an example from Ireland). At the same time, this is a relatively novel form of intervention, frequently developed with a specific focus on fast growing, innovative, SMEs, which has not been the subject of systematic policy evaluation.

Box 11. InterTradeIreland: Getting Irish SMEs investor-ready

InterTradeIreland is a cross-border trade and business development body funded by the Department of Enterprise Trade and Investment (DETI) and the Department of Jobs Enterprise and Innovation (DJEI). Its goal is to support Irish SMEs by helping them explore new cross-border markets, develop new products, processes and services and become investor ready.

In acknowledgment of the fact that one of the biggest challenges for equity raising businesses is to become ‘investor ready’, the organisation offers varied support measures in order to increase Irish SMEs’ chances of success when seeking venture finance. Programmes and services typically target more established SMEs that already have a satisfactory trading record. Offered services to foster investor readiness include, among other things:

- One-on-one counselling interviews with an advisor specialised in equity, venture capital and business development, providing guidance to early stage, high growth ventures that intend to raise funds in the next 12 months. He advises on the firm’s fundraising requirements and assesses its ‘investor readiness’ by acting as a sounding board for the SME management team before they approach the investment community to seek capital.
- A series of free, monthly clinics and regional workshops are held at various locations across the island each month for established local SMEs who are interested in learning about new and alternative sources of finance for their business and that fulfil certain eligibility criteria. The events aim to encourage SMEs seeking finance to do so in a strategic manner with a well-prepared business plan and to explore all finance options available to them.
- The Seedcorn Investor Readiness Competition mirrors the real life investment process and aims at improving firms’ ability to attract investment. The competition is aimed at early and new start companies that have a new equity funding requirement and has a total cash price fund of EUR 280 000.
- An annual venture capital conference and regular “Meet the Funder” events aimed at companies with growth ambitions, providing information on and access to a range of funding providers, and advice on how to approach the funding process. At the events companies are also given opportunity to network with funding providers.

In addition, InterTradeIreland offers Funding Advisory Services, mostly in the form of online material that firms can download form the organisation’s website. The materials include guidance on how venture funding works, what investors are looking for as well as a breakdown of all the venture funds and business angel networks on the island and their contact details in one searchable database, but also hints and tips on refining the business plan and tailoring it to specific investor needs.

Source : http://www.intertradeireland.com/.

4.7. Support to industry networks, associations and the facilitation of links between entrepreneurs and investors

The majority of OECD countries have programmes in place to develop “social networks” linking entrepreneurs seeking finance with investors, for example by providing support to business angel networks (BANs). These networks often also aim to connect investors with other financial players in the financial eco-system, such as government agencies, stock exchanges, financial consultants, venture capital associations, banks, incubators and crowdfunding platforms. The creation of links between investors, entrepreneurs and larger companies, are of particular importance, since they can potentially lead to an increase of successful exits of investments (see Box 12). Matchmaking services are often

complemented by additional support and mentoring services, both for (potential) investors and entrepreneurs and SMEs (OECD, 2013c).

Box 12. "Better by Capital": Capital connections for New Zealand's SMEs

"Better by Capital" is a programme developed by New Zealand Trade and Enterprise (NZTE), the government's international business development agency. Launched in July 2013, it is one of the numerous initiatives in the Building Capital Markets of the Government's Business Growth Agenda and run in partnership with New Zealand and international financial institutions, intermediaries, banks and investor networks.

The programme's overarching goal is to render the capital raising process more transparent and improve SMEs' chance of accessing the right type of funding that corresponds to the firm's stage in its lifecycle. It seeks to accelerate the ability of companies to access alternative capital markets, improve their capacity to be "match fit" when sourcing new capital, and shift their marketability away from traditional, more standard financial instruments to better support firm growth.

The programme consists of three-stages that first help companies understand their capital options (Orientation), subsequently improve their investment proposition (Readiness), and ultimately ensure companies attract the right capital, from the right providers at the right time (Connections). Since New Zealand-based and international investment managers administer the programme, which is delivered in partnership with private sector specialists with capital raising experience, a core element of the programme is to help SMEs build key relationships by facilitating introductions to targeted investors and networks.

In addition, NZTE also runs a series of annual investment showcases to present investment deals to international and domestic investors.

Source : https://www.nzte.govt.nz/en/.

Increased support for business angel networks is a good example of a 'demand-side' policy that seeks to improve the exposure of high-quality firms available to these investors. Currently, angel markets in many countries are essentially constituted by anonymous individuals operating within a fragmented system. For these investors to be in a position to make sizeable initial investments and undertake appropriate follow-on investments in a manner that mirrors the professionalism of institutional venture capital investors, markets would have to evolve considerably toward an increasingly co-ordinated network of professionally organised groups. Improving the flow of high quality deals from such networks to venture capital funds should thus be a priority for policy makers (Nesta/BVCA, 2009).

With regard to the provision of general networking opportunities and exchange of knowledge among peers, SME Corp Malaysia, the Malaysian SME agency, has developed a number of programmes to support small firms. In recognition of the value of systematic and intelligent networking, which allows for the identification of synergies and the establishment of linkages between SMEs and large companies, the agency designed its Business Linkage (BLing) Programme to create such opportunities for through Business Matching Sessions conducted at annual flagship events, as well as leveraging on various other platforms and opportunities. As of 31 December 2014, the programme had generated a total of RM 428.6 million in potential sales through 536 sessions involving 303 SMEs. In addition, SME Corp. Malaysia organises the SME Annual Showcase – SMIDEX, an annual event that showcases capabilities and capacities of Malaysian SMEs in offering products, services and technologies for the global market. SMIDEX also provides Business Matching Sessions with the aim of assisting SMEs to establish strategic business partnerships and business linkages, as well as to facilitate meaningful exchange of functional knowledge with large enterprises.

5. Main findings and concluding remarks

Since bank credit is and will remain the main source of finance for SMEs, it is important to stress the complementarity of bank lending and alternative financing tools for SME development. This is underscored in the G20/OECD High-Level Principles on SME Financing developed in 2015, which advocate a two-pronged approach to improving access to credit to SMEs and developing a diversified financial offer for SMEs. This will enable SMEs to reduce their vulnerability to changes in credit market conditions, strengthen their capital structure and enhance their ability to contribute to economic growth, employment, innovation and social cohesion. This is all the more important given that some SMEs are not appropriate candidates for debt financing, owing also to their lack of collateral or positive cash flows, their need for longer maturities to finance capital expenditure and investment, or other impediments to servicing debt, such as irregular cash flow generation. Available evidence strongly suggests that there is an equity gap for risk financing, and in particular for fast-growing companies. Yet it is precisely these types of instruments which, if further developed, could play an important role in funding the firms which have the greatest potential to grow and create jobs. However, SME funding continues being viewed as an overall difficult business, mainly because the segment as a whole is characterised by low survival rates and large heterogeneity, which makes it considerably more challenging to assess risks or gauge the potential for positive returns on investment (Nassr and Wehinger, 2016).

Broadening the range of financing instruments is therefore essential to address diverse financing needs along the firm's life cycle. It is important to recognise that both demand- and supply-side challenges to SME finance exist, such as skills and financial education, as well as the role of the broader regulatory and business environment in fostering or impeding the development of a range of financing instruments. The obstacles discussed in this paper result in a pronounced mismatch between SME financing needs and the funding available to them, which was further exacerbated by the financial crisis. As the previous sections have shown, challenges in the provision of finance to small firms can be motivated by supply-side or demand-side factors, but go overall beyond this dichotomy due to a complex interaction of both structural and cyclical variables that need to be adequately addressed as well. However, disentangling these effects is often difficult, since changes in demand and supply are generally contemporaneous.

In essence, the problem of thin markets is illustrative of a situation in which the co-ordination of supply and demand is made difficult because it is mediated in highly uncertain, complex markets, comprised of a range of different institutions. Such markets are demanding because they are knowledge intensive and usually have to operate over long periods of time before clear results on performance become available. Under such conditions, a key issue relates to the length of time that is needed to build up managerial capabilities in both funds and firms. This suggests that policy emphasis on firm growth and building up the necessary human capital is needed to grow high impact firms in both VC funds and investee firms, as well as on building the skills of would-be entrepreneurs. Table 3 below summarises key obstacles and matches these with potential policy actions. It is important to note, however, that many of the listed policy measures can simultaneously address several challenges.

The difficulties in developing alternative instruments stem to a significant extent from demand-side challenges, including a lack of financial knowledge of many entrepreneurs and business owners, who are sometimes unaware of the existence of alternatives to bank lending and, even if they are, are very often unable or unwilling to comply with the requirements of professional investors. Insufficient financial knowledge often also prevents SMEs from seeking out the instruments which are most suited to their needs. Unfavourable tax treatment of some of these alternatives may also be an obstacle to their expanded use.

On the supply side, despite many government initiatives to develop the use of equity-type instruments for SMEs, (institutional) investors are hesitant to invest in SMEs because of large information asymmetries, a scarcity of transparent credit data, regulatory obstacles such as the asymmetric treatment of equity and debt financing, as well as insufficient investment opportunities. The lack of a risk equity culture across many countries is another important obstacle to the fostering of SME equities, not further discussed in this paper, yet with striking comparisons between the United States (50% of the population invested in equities) and parts of continental Europe (e.g., only 5% of the population with direct equity investments), as evidenced by the 2015 AFME/ Boston Consulting Group investor survey. This calls for increased education regarding equity investments for all market constituencies (SMEs, individual investors and advisors alike) and the need to induce participation by both institutional and possibly also retail investors (e.g. private pension schemes) in order to foster the development of vivid and liquid growth markets.

Table 3. Challenges for the development of non-bank finance instruments for SMEs

POLICY OBSTACLE	MAIN AREA OF CONSTRAINTS	POTENTIAL POLICY ACTION	STRUCTURAL MEASURES
Demand-side	Lack of awareness, negative perceptions and inability to access alternatives to bank finance	• Consider a national strategy to foster financial literacy, ideally with a specific focus on SMEs • Develop financial education programmes for entrepreneurs and would-be entrepreneurs, including through incubators • Develop investor-readiness programmes	• Address the fragmentation of SME financial markets • Improve the liquidity and scale of markets (thin markets problem) • Help to develop an SME finance ecosystem • Create links and matchmaking services between (potential) investors, entrepreneurs and large companies • Monitor and evaluate public policies in this area
	Lack of financial skills and vision	• Enhance SME financial skills and strategic vision by offering advisory services to improve accounting, financial management and overall business development • Complement the provision of financial support to SMEs with non-financial elements such as counselling and monitoring	
	Disadvantageous tax treatment of equity instruments	• Encourage tax neutral regulation • Support a range of financing instruments for SMEs, e.g. via tax deductibility for innovative start-ups that participate in entrepreneurship trainings or in incubator programmes	
Supply-side	Opacity of the SME market	• Improve transparency and provide targeted information, e.g. by credit registries or bureaus for SMEs and rating services going beyond collateral and historical financial information • Identify SME financing needs and gaps and improve the evidence base	
	Regulatory ambiguity or barriers to entry in the SME market	• Design regulation that supports a range of financing instruments for SMEs, while ensuring financial stability and investor protection	
	Limited exit options	• Lower the costs of IPOs • Introduce measures that reduce the length of time between investing and exiting • Considering the needs of equity investors when designing regulation	

Recognising the need for better access of SMEs to equity capital markets, there is a role for policy makers to catalyse institutional long-term investor participation in SME quoted markets. High monitoring costs, absence of track record and other information asymmetries, which are prominent across the board of SME financing, can be addressed though measures and tools that improve transparency that may also involve the public sector. Thus, public authorities have an important role to play in the creation of an improved informational infrastructure, an element now widely recognised as central for the development of an efficient SME financing ecosystem. Furthermore, governments can help bridge the educational gap of SMEs when it comes to financial markets by raising their awareness

of available capital market financing options and equipping them with the skills required to tap the public markets. A co-ordinated approach on regulation, including a neutral tax framework, which reduces asymmetric treatment of debt and equity, can help avoid distortions in risk pricing and stimulate investor appetite. Finally, the need for improving the evidence base about SME debt and non-debt financing should be recognised. The lack of hard data on SMEs access to diverse financing instruments represents an important limitation for the design, implementation and assessment of policies in this area. The implementation of the G20/OECD High-Level Principles on SME Financing would go a long way to addressing these issues.

Overall, a more nuanced view of the challenges associated with SMEs' access to finance may be called for. In order to develop complementary finance instruments for SMEs, demand-side and supply side barriers need to be addressed in tandem. Even if supply-side barriers are lifted, alternative sources of finance will remain underdeveloped as long as entrepreneurs continue to turn to bank lending as their default option when seeking finance. Conversely, tackling demand-side barriers will lead to limited success if supply-side issues continue to be a bottleneck. At the same time, an integrated market perspective should also take account of the time needed to put in place the various conditions for a well-functioning framework for SME financing that is complex and composed of many elements and players. Thus, a comprehensive approach to the small firm equity finance problem is needed to address both demand- and supply-side obstacles (including issues of skills and managerial expertise).

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